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No. ——

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, *et al.*, *Petitioners*,

v.

PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California, *Respondents*.

Petition for a Writ of Certiorari to the Court of Appeal of California Third Appellate District

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a State's decision to impair its own contractual obligation solely in order to save public monies violates the Contract Clause of the United States Constitution.

2. Whether clear, mandatory state constitutional and statutory provisions governing the terms of a public employee pension plan are protected under the Contract Clause of the United States Constitution, where the State traditionally has viewed its pension obligations as contractual.

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PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California,
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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully request that a writ of certiorari issue to review the judgment of the Court of Appeal of California, Third Appellate District.[1]

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[1] Petitioner, The Board of Administration of the Public Employees' Retirement System of the State of California, was a

OPINIONS BELOW

The opinion of the California Court of Appeal is reprinted in the Appendix ("Pet. App.") at 1a. The court's order modifying that opinion is reprinted at Pet. App. 44a. The opinion, without modifications, is reported in the advance sheets at 6 Cal. Rptr. 2d 77. The opinion as modified will appear at the same cite in the bound volumes. The court's opinion denying rehearing is unreported and reprinted at Pet. App. 46a.

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nominal respondent below because California law requires it to enforce the challenged statute even if it disputes its validity. Cal. Const. art. III, § 3.5(a). The Board is nevertheless authorized to contest the lawfulness of the statute, as it has throughout these proceedings. *See* Pet. App. 1a-2a.

The other petitioners in this Court are Peggy J. Claypool; Ivory Blunt; Raymond Campbell; Robert Copp; Roy Cuckovich; Clara H. Dieterle; Milton Dobkin; Arthur Hayes; Alan Hardy; Elnora E. Hoyt; Robert Katz; Andrew J. Legg; Dixie Lowder; John B. Matheny; Jerry Matthews; N. Deane Moore; Linda L. Pinkerton; Yolanda Solari; John H. Thompson; Fran Victor; Marshall Walker III; Candy Workman; The American Federation of State, County, and Municipal Employees, AFL-CIO; Association of California State Attorneys & Administrative Law Judges; California Association of Highway Patrolmen; California Association of Professional Scientists; California Association of Psychiatric Technicians; California Department of Forestry Employees Association, AFL-CIO; California Federation of Teachers, AFL-CIO; California Professional Firefighters, AFL-CIO; California Independent Public Employees Legislative Council; California School Employees Association; California State Employees Association; California State Firefighters' Association, Inc.; California State University Emeritus and Retired Faculty Association; California Union of Safety Employees; Professional Engineers in California Government; Retired Public Employees' Association; Sacramento Area Firefighters, Local 522, IAFF, AFL-CIO; and Service Employees International Union, AFL-CIO. The parties in the courts below consist of these petitioners, the respondents listed in the caption here, and one other original petitioner, the Sacramento Police Officers Association.

No petitioner has any disclosure to make under Rule 29.1.

JURISDICTION

The judgment of the California Court of Appeal was entered on March 12, 1992, and timely petitions for rehearing were denied on April 13, 1992. On June 18, 1992, the California Supreme Court denied timely petitions for review. On August 14, 1992, Justice O'Connor extended the time for filing a petition until October 16, 1992. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Contract Clause of the United States Constitution (art. I, § 10), as well as several provisions of California statutory and constitutional law. The Contract Clause provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." The pertinent California provisions are set forth at Pet. App. 53a, *et seq.*

STATEMENT

Petitioners seek review of a decision of the California Court of Appeal upholding a 1991 statute in which the California legislature responded to a fiscal crisis by (1) cutting benefits and eliminating protections in a pension program covering nearly a million public employees and retirees and (2) expropriating $1.9 billion of trust funds previously committed to pay pension benefits and using them instead to satisfy public employer obligations to the pension program. The constitutional challenge to this statute was primarily based on the Contract Clause, U.S. Const. art. I, § 10. The court below assumed that some of the changes made by the legislature did impair the contract rights of employees, but held that these impairments were constitutionally permissible. The court also held that other challenged features of the law did not involve contractually protected interests and thus did not implicate the Contract Clause.

1. *Factual Background.* The California Public Employees' Retirement System ("PERS") is a statutorily created program for paying retirement benefits to employees of the State, local school districts, various municipalities, and many other public bodies that have entered into contracts with PERS. Funds for these benefits come from fixed employee contributions, employer contributions calculated on an actuarial basis, and income earned on money already in PERS accounts. The system is administered by one of the petitioners here, the Board of Administration of the Public Employees' Retirement System, which serves as trustee of the funds. The other petitioners are current and former employees who are members of PERS, and organizations representing those members. *See generally* Cal. Gov't Code § 20000, *et seq.* (West 1980).

Under the PERS statute, all retiring employees receive a defined pension benefit, based on salary, age, and years of service, and a minimal cost-of-living adjustment (COLA), generally at the rate of two percent a year. Prior to July 1, 1991, the statute also had several other key features, which form the basis of the contractual claims at issue here. To begin with, it provided two types of supplemental benefits designed to protect pensioners from the effects of inflation above the two-percent, fixed COLA level. The Investment Dividend Disbursement Account (IDDA), originally enacted on a temporary basis in 1982 and made permanent in 1988, provided a PERS member with the right to a supplemental benefit ensuring that his pension maintained 75 percent of its original purchasing power, when the PERS Board determined that sufficient funds were available for this purpose. Cal. Gov't Code § 21235 (West Supp. 1989). The Extraordinary Performance Dividend Account (EPDA), created in 1988, provided a PERS member with the right to a second supplemental benefit, protecting the original purchasing power of his pension beyond the 75 percent level, when the Board determined that sufficient funds were available. *Id.* § 21238.

The IDDA and EPDA benefits were both funded entirely with "excess" earnings on money from *employee* contributions to PERS. Under the pre-1991 statute, the PERS Board was authorized to decrease the earnings credited to the employees' contributions down to the actuarially predicted rate, in order to create a surplus to pay these supplemental benefits. *See id.* §§ 20026, 20026.1, 20131, 20684 (West 1980 & Supp. 1989). The actual earnings on employee contributions, if they exceeded these pre-set estimates, were allocated to the IDDA and EPDA. *Id.* §§ 21235(a), 21237(b) (West Supp. 1989).[2] From its inception in 1983 until 1991, the IDDA benefit had been paid at the 75 percent level every year, and the EPDA benefit, first paid in 1991, brought the level to 80 percent. By 1991, moreover, $1.9 billion had accumulated in these accounts and were being held as reserves to pay IDDA and EPDA benefits in the future.[3]

In addition to making the key decisions regarding funding and payment of the IDDA and EPDA benefits, the PERS Board, for some forty years prior to 1991, had overall statutory authority for the financial soundness of the program, which included responsibility for setting employer contribution levels on the basis of actuarial analyses. *Id.* §§ 20127, 20130, 20750.9. (West 1980). The Board is an independent state agency, made up of six members who are either state officials or gubernatorial appointees, six members elected by employees and pension recipients, and one public member selected by the leaders of the legislature. *Id.* § 20100 (West Supp. 1992).

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[2] In practice, the estimated rate was set at 8.5 percent, while actual earnings during the 1980s consistently were at least 1.5 percent higher.

[3] A third benefit paid out of these funds, referred to in the opinion below as the "Boatwright benefit" (Pet. App. 6a), was a precursor to the IDDA benefit and was gradually being subsumed into it, and thus, for simplicity's sake, we omit any discussion of it.

In 1991, California faced a large budget deficit. In response, the legislature, with extreme haste, enacted the statute challenged here.[4] This statute, commonly referred to as "Chapter 83" (1991 Cal. Stat. ch. 83), made major changes affecting the pension rights just described.

First, the legislature repealed the pre-funded IDDA and EPDA benefits, replacing them with a new supplemental benefit program, to be funded out of current-year income on employee accounts. Under this program, retirees are entitled to receive up to (but not more than) 75 percent of the original purchasing power of their pensions, subject to the availability of funds. Ch. 83, § 36 (codified at Cal. Gov't Code § 21235.5). Funding for this new benefit comes largely from an annual transfer of up to 1.1 percent of the employee assets held by PERS; and funds cannot accumulate from one year to the next. *Ibid.*[5]

Second, the legislature directed that all of the $1.9 billion of trust funds then existing in the IDDA and EPDA reserves "be used to reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted." *Id.* § 17 (codified at

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[4] The various legislative proposals that led to this statute were only circulated during a two-week period prior to its passage. Certain key features, including the transfer of actuarial responsibility from the PERS Board to a political appointee, were not even proposed until the same day that they were passed, without hearings, by the legislature. *See* Decl. of David Low (attached to Petitioners' Reply Memorandum in the Court of Appeal, filed November 22, 1991).

[5] A minor amount of additional funding comes from a new cap on the interest rate paid to those employees who withdrew their individual accounts if they leave public service prior to retirement. *See* ch. 83, § 29.5 (codified at Cal. Gov't Code § 20652.5).

Cal. Gov't Code § 20131.01). This meant that state and local employers were relieved of their obligation to make current contributions to the PERS Fund.

Third, the new statute transferred actuarial responsibility for the program's financial soundness from the PERS Board to an actuary appointed by the Governor, with the consent of the legislature. *Id.* §§ 5, 6, 14, 31 (codified at or amending Cal. Gov't Code §§ 20006, 20006.1, 20130, 20750.905). Consequently, it is now up to this contract actuary, in his discretion, to determine the required amount of the State's contributions to PERS.[6]

2. *Proceedings Below.* Petitioners challenged these three aspects of Chapter 83 in an original action in the California Court of Appeal, claiming, *inter alia*, that they unconstitutionally impaired the contract rights of PERS members.[7] The Court of Appeal rejected each claim. As to the first—the elimination of IDDA and EPDA benefits—the court "assumed" for purposes of its analysis that employees who worked after January 1, 1989, when these benefits were permanently established by statute, had a contractual right to them. Pet. App. 20a.[8] Despite this right, however, the court held that

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[6] Chapter 83 also provided that certain future state employees would be required to enter a "second tier" pension system, under which the employees make no contributions, employer contributions are capped at a fixed level, and lesser benefits are paid. Such new employees may only participate in a contributory system if and when the State and the employees' representatives agree to a pension program that maintains the second-tier caps on employer contributions. Ch. 83, § 7 (codified at Cal. Gov't Code § 20013.75).

[7] Petitioners also raised state law claims and claims under the Due Process Clause of the United States Constitution.

[8] The court ruled that employees who had retired prior to 1989 did not have a contractual right to the IDDA and EPDA benefits, because EPDA did not exist at a time when they worked and IDDA was only a temporary program then. Pet. App. 15a-19a.

the State's unilateral elimination of the IDDA and EPDA benefits, coupled with its creation of the new supplemental benefit, did not violate the Contract Clause.

The court reached this result by applying a two-part test traditionally used in California (and numerous other States, *see* p. 25 *infra*), which provides that state-imposed changes to a pension contract with public employees are constitutionally permissible as long as (1) the changes " 'bear some material relation to the theory of a pension system and its successful operation,' " and (2) any changes that result in " 'disadvantage to employees [are] accompanied by comparable new advantages.' " Pet. App. 15a (quoting *Betts v. Board of Admin.*, 582 P.2d 614, 617 (Cal. 1978)). In this case, the court concluded, the basis for the change—"the saving of public employer money [that would otherwise have had to have been paid to PERS]"—was properly related " 'to the theory of a pension system and its successful operation.' " Pet. App. 20a-22a. The court also ruled that the second part of the test was satisfied here, finding that the new supplemental benefit is "comparable" to the repealed IDDA and EPDA benefits. *Id.* at 22a-27a.

The court next held that the diversion of the existing $1.9 billion in reserves (earnings on employee contributions that had been earmarked for supplemental employee benefits) to fund current employer contributions to PERS did not contravene petitioners' contract right to have PERS trust funds used "for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." Cal. Const. art. XVI, § 17(a) (added in 1984). The court reasoned that, although the $1.9 billion was being used to pay employer contributions to PERS, the monies themselves would, quite literally, "remain PERS assets until

they are paid to PERS members or beneficiaries or to defray the costs of administration of the system." *Id.* at 33a.

Lastly, the court rejected petitioners' claim that the transfer of actuarial responsibility, including the authority to set the level of employer contributions, from the independent PERS Board to an actuary appointed by the Governor, violated their contract rights. Despite the statutory provisions expressly conferring this procedural protection on petitioners (p. 5 *supra*), the court concluded that there is "no ground for implying a statutory promise that the duty of performing these functions would not be transferred to another entity." Pet. App. 41a.

The California Supreme Court denied petitions for review, Justices Stanley Mosk and Joyce Kennard dissenting.

REASONS FOR GRANTING THE WRIT

This case presents two important issues concerning the application of the Contract Clause of the United States Constitution, art. I, § 10, cl. 1.

First, the California Court of Appeal ruled that the State's interest in saving money provides a constitutionally adequate basis for it to impair its own contracts. This Court, however, has already rejected that view: "If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *United States Trust Co. v. New Jersey*, 431 U.S. 1, 26 (1977) (footnote omitted). In any event, if, as it appears from the decision below, there remains some doubt about this basic proposition of constitutional law, this Court should clarify it before other States faced with similar financial pressures follow California's example.

Second, the California Court of Appeal ruled that, despite clear, pre-existing statutory mandates protecting employees, no contract rights were implicated by amendments that (a) siphoned off almost $2 billion of trust funds already committed for employee benefits in order to satisfy employer obligations, and (b) substituted a political appointee for an independent board as the party responsible for decisions affecting the required amount of future employer contributions to the trust fund. This process of "interpreting" contract rights in a way that nullifies Contract Clause claims raises special concerns because it effectively allows a State to avoid constitutional scrutiny of its own self-serving actions. To correct that kind of abuse—and to remind the lower courts that the Contract Clause has "not become a dead letter" (*Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938))—the need for this Court to review state law rulings in Contract Clause cases remains a constitutional imperative.

This case presents an appropriate vehicle for considering these issues. The rulings below reflect a deep confusion concerning the application of basic Contract Clause principles to long-term, ongoing state obligations that arise under public employee pension programs. The state courts are in considerable disarray over this constitutional issue. Several states generally follow California's flexible Contract Clause approach to pension modifications (using the two-part test employed here), while others impose a more demanding standard of constitutional scrutiny. *See* p. 25 *infra* (citing cases). The need to clarify the law in this area is especially great now: numerous states and localities currently face substantial deficits, thus heightening the political temptation to raid well-funded public employee pension plans; and, unless corrected, the decision in this case is certain to embolden other state and local governments.

I. THE STATE'S INTEREST IN SAVING MONEY IS A CONSTITUTIONALLY IMPERMISSIBLE BASIS FOR IMPAIRING ITS CONTRACTS.

The California Court of Appeal assumed that employees who worked after January 1, 1989, had a right under their employment contracts to receive IDDA and EPDA benefits in accordance with the terms of the statutory provisions that were in effect when they rendered their services. The court nevertheless held that the State is free to disregard such a contractual obligation solely in order to save itself money, as long as it provides another benefit—found to be "comparable" by a court, though not by the party who holds the contract right. This view of the Contract Clause is seriously flawed. If that provision is to have any force, a State's decision to renege on an agreement simply because it is "too expensive" must be constitutionally impermissible. That fundamental conclusion is not altered by adding a self-contradictory "comparability" prong to the constitutional inquiry.

1. The language of the Contract Clause is unequivocal: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." Nevertheless, this Court has held that "the prohibition is not an absolute one" because the Clause cannot sensibly be read to divest a State of the "essential attributes of sovereign power." *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 428, 435 (1934). Thus, "an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. at 25.

This general standard is applied "more stringent[ly]" (*Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978)) when, as here, the State impairs its own contracts, because then "the State's self-interest is at stake." *United States Trust Co.*, 431 U.S. at 26. Indeed, "[i]n almost every case, the Court has held a governmental unit to its contractual obligations when it

enters financial or other markets." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 412 n.14 (1983) (citing cases); *see also United States Trust Co.*, 431 U.S. at 24 ("the Court has regularly held that the States are bound by their debt contracts") (footnote omitted); *cf. Murray v. Charleston*, 96 U.S. 432, 445 (1878) ("[t]he truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties").

Specifically as regards this case, the Court has made clear that the Contract Clause flatly prohibits a State from impairing its contractually imposed "financial obligations" so that it can "spend the money for what it regard[s] as an important public purpose." *United States Trust Co.*, 431 U.S. at 26. As the Court recognized in that case, were such a money-saving justification deemed constitutionally permissible, "the Contract Clause would provide no protection at all." *Ibid.* Following this lead, the federal courts of appeals have rejected money-saving impairments even when the State faces enormous, unanticipated financial burdens under a contract, and even when the State is in the midst of a fiscal crisis. *See Continental Illinois Nat'l Bank & Trust Co. v. Washington*, 696 F.2d 692, 696 n.8, 701-02 (9th Cir.), *appeal dismissed*, 460 U.S. 1077 (1983) (State barred from restricting authority of public agency to sell bonds, as provided by contract, where it sought to avoid unforeseen obligations totalling billions of dollars); *Association of Surrogates & Supreme Court Reporters v. New York*, 940 F.2d 766 (2d Cir. 1991) (State cannot suspend employees' contract right to salaries in order to provide funds needed for operating the judicial system).

This fundamental limitation on a State's ability to impair its own contracts is directly tied to the reason for relaxing the Contract Clause's unequivocal mandate in the first place. It is one thing to fashion a doctrine,

based on necessity, growing out of the recognition that certain police-power options—*e.g.*, protecting public safety—cannot be contractually limited if the State is to be able to govern. *See Stone v. Mississippi*, 101 U.S. 814, 817 (1880) ("[t]he legislature cannot bargain away the police power of a State"); *United States Trust Co.*, 431 U.S. at 23-24 & n.20 (citing cases). But, for several reasons, it is a very different thing to say that hard financial times should allow a State to abandon its freely undertaken contractual obligations. Most importantly, there is no real "necessity" in this latter situation; other spending cuts or revenue increases, though often unpopular, are always available. Moreover, in contrast to situations where unforeseen circumstances may create a need for flexibility, state-contracted debts typically will be (as here) readily foreseeable. And finally, a State obviously has wide discretion to set or reject contract terms at the outset when it is dealing in traditional commercial areas like employment or product acquisition.

2. The California Court of Appeal's decision never came to grips with these settled constitutional principles. Instead, the court quickly concluded that a money-saving purpose is permissible, at least when the State "provide[s] comparable advantages to the employees whose contract rights are modified." Pet. App. 22a. In so ruling, the court purported to be applying a two-part test previously adopted by the California Supreme Court, which provides that "a modification of a vested pension right is reasonable only if it 'bear[s] some material relation to the theory of a pension system and its successful operation, and changes in [it] which result in disadvantage to employees [are] accompanied by comparable new advantages.'" *Id.* at 20a (quoting *Betts*, 582 P.2d at 617).[9] This analysis is pervasively unsound: the test,

[9] The California Supreme Court has made clear that this two-part test is based on the application of this Court's "[Contract Clause] principles to the modification of rights arising under the retirement

on its face, makes no sense in this context; the substitution of a court's assessment of benefit comparability for that of the contracting party cannot legitimate an otherwise impermissible reason for impairing a contract; and the court's finding of comparable-benefits-for-less-money here cannot withstand scrutiny.

a. The two-part test used by the court below, while enjoying a lengthy pedigree in California pension cases, has never before been applied in this fashion. The test was established "for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system." *Allen v. City of Long Beach*, 287 P.2d 765, 767 (Cal. 1955). In accord with that purpose, previous California cases demonstrate that this test is designed to allow the State to make modifications that *improve* the overall quality or security of pension plans. *See, e.g., Houghton v. City of Long Beach*, 330 P.2d 918, 922 (Cal. Ct. App. 1958) (imposition of employee contribution requirement validly offset by the city's new commitment that pension would be a general obligation, rather than a right conditioned on availability of funds); *Downey v. Board of Admin.*, 121 Cal. Rptr. 295, 303 (Ct. App. 1975) (contribution increase validly offset by increase in benefits).

Whatever its merit in that kind of situation, however, this test cannot sensibly be applied to assess the validity of benefit changes made for the express purpose of saving an employer money. The simple fact is that the State cannot save money by substituting one benefit for another, while simultaneously making the new benefit "comparable" to the old. After all, pension benefits are nothing but

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laws of this state." *Allen v. Board of Admin.*, 665 P.2d 534, 538 (Cal. 1983) (citing, *inter alia, United States Trust Co., supra; City of El Paso v. Simmons*, 379 U.S. 497, 508 (1965)). *See also Betts v. Board of Admin.*, 582 P.2d at 619 (failure to meet two-part test means pension modification "cannot constitutionally be applied").

monetary payments and thus a cheaper benefit is just not a comparable one. Until this case, therefore, the California courts uniformly struck down these kinds of money-saving impairments of contract rights. *See, e.g., Betts v. Board of Admin., supra; California Teachers Ass'n v. Cory*, 202 Cal. Rptr. 611 (Ct. App. 1984); *Valdes v. Cory*, 189 Cal. Rptr. 212 (Ct. App. 1983).

b. More fundamentally, the Court of Appeal's approach impermissibly compresses the constitutional inquiry. This Court has insisted that, to pass muster, contractual impairments must be both "reasonable" *and* "necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. at 25. But in California, it now appears that a contract right can be abrogated simply if a new right, judged "comparable" by a court, is provided in its stead. *See* Pet. App. 22a ("[w]e hold only that the monetary objective will not invalidate a modification which [provides comparable advantages to the employees]"). This complete elimination of the "necessity" prong in Contract Clause analysis (even assuming that "comparability" is a proper surrogate for "reasonableness") guts the standard of any constitutional legitimacy.

The whole theory of contract law rests on the notion that "parties may contract as they wish, and courts will enforce their agreements without passing on their substance." *Restatement (Second) of Contracts*, ch. 8, intro. note (1981). The constitutional approach followed by the court below, however, simply disregards this paramount principle and allows the courts to decide that a second contract right is about as good as the first. In sharp contrast, this Court's requirement—that a State show its impairment of a contract is "necessary to serve an important public purpose" (*United States Trust Co.*, 431 U.S. at 25)—properly ties the Contract Clause to the underlying theory of contract law, by insisting that the parties' evaluation of the bargain will be enforced *unless* there is an overriding state interest present. Only when

that preliminary condition is satisfied, we submit, is it even relevant to look into the reasonableness of the impairment, a consideration that *is* rightly affected by comparability considerations. *See United States Trust Co.*, 431 U.S. at 29-32; *see also General Motors Corp. v. Romein*, 112 S. Ct. 1105, 1109-10 (1992); *Allied Structural Steel Co.*, 438 U.S. at 242-51.

c. The California Court of Appeal's analysis of "comparability" confirms, on a practical level, that its approach does not meaningfully protect the constitutional rights of contracting parties. The court was able to find comparability between the old and the new supplemental benefit programs here only by ignoring relevant factual issues and by relying on highly questionable actuarial projections. If the court had conducted a complete and correct analysis, it would have come to the obvious conclusion that the State could save money by eliminating contract rights to the IDDA and EPDA benefits only because it provided a less-than-comparable substitute.

To start with, the court focused on whether the reduction in the *maximum* benefit (from 80 percent then being paid under EPDA to 75 percent under the new system) would in fact affect post-1988 retirees. It concluded that, by the time these retirees became eligible for supplemental benefits, there would no longer have been funds available to pay EPDA benefits. In so doing, the court relied on disputed projections of future funding and on the fact that future employee contributions would be reduced by the diversion of new state employees into a non-contributory plan. But this conclusion—acknowledged by the court to be key to its comparability finding—rests in no small part on guesswork, such as "assuming a 5 per cent inflation rate" over a period of "*nine* years." Pet. App. 24a (emphasis added). Indeed, petitioners submitted testimony showing that these projections generally were based on unlikely, "worst-case" assumptions. *See* Decl. of Stephen J. Hoeffner (attached to the Letter Brief

of the PERS Board in the Court of Appeal, filed November 22, 1991). Moreover, the diversion of new state employees into a non-contributory pension plan was largely irrelevant to a reasoned analysis of future benefits.[10]

To make matters worse, the court gave only passing consideration to the overall comparability of the new and old benefits *below* the statutory maxima. When that issue is looked at, it becomes apparent that Chapter 83 is demonstrably less beneficial than the IDDA and EPDA program, because the funds for the new benefit are capped at *1.1 percent* of the monies in employee accounts in a given year,[11] whereas funding for IDDA and EPDA benefits always had exceeded *1.5 percent* of these monies. Moreover, under the old program, but not the new one, reserves were carried forward over the years, thus allowing a good year to cushion the effect of a bad one and thereby substantially increasing the financial security of

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[10] This diversion covered only about one-fourth of PERS members (the others being non-state members) and, by statute, even these state members will participate in a contributory plan if one is negotiated with their unions. Ch. 83, § 7 (codified at Cal. Gov't Code § 20013.75). More importantly, under the IDDA and EPDA program, a loss of contributions from *state* employees would not have significantly affected the benefits for local and school employees—because funds for separate categories of employees were kept in separate "purchasing power accounts." *See* Decl. of Edward H. Friend, at 9 (attached to the Petition for a Writ of Mandamus in the Court of Appeal, filed July 30, 1991). The new supplemental benefit does not maintain such a separation, thus making it likely that all members will suffer if new state employees remain in a noncontributory plan. *See ibid.*

[11] In addition to the 1.1 percent diversion, the new system also funds supplemental benefits by reducing to 6 percent the interest paid when employees leave public service before retirement and seek a distribution of their individual contribution accounts. But the sums produced in this way are, relatively speaking, *de minimis*. *See* Decl. of Edward H. Friend, *supra*, at 7 n.2.

future payment levels.[12] Indeed, as noted, the IDDA and EPDA reserves, at the time they were expropriated by the State, had reached the level of $1.9 billion.

These various differences between the two benefits—which, of course, represent the money-saving dimension of the contract modification—amply demonstrate the inherent illogic of trying to harmonize two irreconcilable objectives—money saving and comparability. They also illustrate why a court should be hesitant to substitute its own *post-hoc* assessment of contract benefits for that of the contracting parties. It is hard to imagine that employees covered by the court's analysis would not have strongly preferred the IDDA and EPDA program to Chapter 83. That supposition is convincingly confirmed by the fact that they have pursued this litigation.

II. THE CALIFORNIA COURT OF APPEAL'S PATENT MISREADING OF STATE LAW ERRONEOUSLY DEFEATED IMPORTANT CONTRACT RIGHTS.

The court below compounded its error by rejecting two major aspects of petitioners' challenge to Chapter 83 on the ground that the disputed modifications did not affect existing contract rights. In particular, petitioners claimed violations based on (1) the use of $1.9 billion of trust funds—which represented earnings on employee contributions that had already been statutorily committed to fund employee benefits—in order to satisfy employer obligations to PERS, and (2) the transfer of overall actuarial responsibility for PERS from an independent board to a single political appointee. The California Court of Appeal's conclusion that these contentions have

[12] This protection significantly undercuts the importance of the fact, noted by the court below (Pet. App. 23a), that funding was variable under the old system but is permanently set at 1.1 percent under the new one.

no basis in state law (and, therefore, raise no federal law issues) is plainly wrong: the claimed contract rights are set forth in unmistakably clear state law constitutional and statutory provisions that define the terms of the pension contract.

This use of state law to insulate Contract Clause claims from potential review by this Court should not go unchecked. More than fifty years ago, the Court held that "in order that the constitutional mandate may not become a dead letter, we are bound to decide for ourselves whether a contract was made, what are its terms and conditions, and whether the State has, by later legislation, impaired its obligation." *Indiana ex rel. Anderson v. Brand*, 303 U.S. at 100; *see D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 470 (1942) (Jackson, J., concurring). But, despite that recognition, the Court has rarely agreed to scrutinize lower court decisions that find no contract rights, especially in state-contract cases. Unless the trend is reversed, the Contract Clause will indeed, as this case demonstrates, "become a dead letter." *Anderson*, 303 U.S. at 100.

1. The Court of Appeal held that the California legislature violated no contract right when it took $1.9 billion of PERS trust funds that had been set aside to pay employee benefits and used them instead to satisfy the employers' obligation to make further contributions to the pension system. The court implicitly assumed that the employees' pension contract contained a "trust" provision, requiring that funds be used only to pay benefits (and administrative costs), but concluded that the State's action here did not violate this provision since the $1.9 billion would still be used, in the literal sense, for such purposes. That hollow analysis dishonors the contract right at issue. The fact that the diverted funds are ultimately used for the proper purpose of paying *employees*' benefits cannot validate the prior improper diversion of those trust funds to pay the *employers*' contributions.

Indeed, this particular right was added to public employee pension agreements precisely in order to prevent what happened here. In 1982, the California legislature had made a similar attempt (though much smaller in magnitude) to pay employer contributions out of earnings on employee contributions to the PERS fund that had been set aside to protect employee benefits. *See Valdes v. Cory*, *supra* (describing these events). In direct response, a proposed constitutional amendment was submitted to the voters in 1984, providing that "[t]he assets of a public pension or retirement system are trust funds and shall be held for the exclusive purpose of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." Cal. Const. art. XVI, § 17a. The ballot arguments in support of this amendment explained that it would (1) " 'guarantee[] that neither the Governor nor future Legislatures will ever be able to use this money for other purposes,' " (2) assure that " 'the *only purpose* for which these trust assets can be used is the delivery of retirement benefits,' " and (3) enact " 'the *sole and exclusive purpose rule* which imposes on fund trustees the legal obligation to perform their duties *solely* in the interest of plan beneficiaries.' " Pet. App. 32a-33a (quoting Ballot Pamp., argument in favor of Proposition 21 as presented to the voters, Prim. Elec. (June 5, 1984), at 26) (emphasis in original).[13] By passing this amendment, the people of California imposed on the legislature the highest duty of trust law—the duty of undivided loyalty—utilizing words having

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[13] A second subsection of this amendment authorizes "[t]he fiduciary of the public pension or retirement system" to, *inter alia*, "minimiz[e] employer contributions thereto." Cal. Const. art. XVI, § 17(b), *quoted at* Pet. App. 32a n.7. The court below properly rejected the State's reliance on this provision, explaining that "[t]he argument is a digression since the subdivision . . . refers to the duties of the trustees and not, save perhaps derivatively when legislating upon that topic, to the duties of the Legislature which are in issue here." Pet. App. 32a n.8.

long-established meaning under trust law. *See NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981) (use of phrase "sole and exclusive benefit[s]" carries with it an "accumulated settled meaning" that "trustee bears an unwavering duty of complete loyalty to the beneficiary of the trust, to the exclusion of all other parties") (citing *Restatement (Second) of Trusts* § 170(1) (1957); 2 A. Scott, *Law of Trust* § 170 (1967)).

These events confirm the common-sense conclusion that trust monies earmarked "solely" for the use of beneficiaries cannot lawfully be diverted to serve the interests of other parties. *Cf. Mosser, Successor Trustee v. Darrow, Former Trustee*, 341 U.S. 267, 271-72 (1951) (trustee may not administer trust to benefit third parties). Instead, these monies should have been retained for their intended purpose—guaranteeing future supplemental benefits [14]—or at minimum returned to the individual *employee* accounts from which they were initially diverted.[15] These options would have allowed the trust's beneficiaries to benefit from the income on their own contributions.

To be sure, it happens to be true that the funds diverted to pay employer contributions "remain PERS assets until they are paid to PERS members or beneficiaries or to defray the costs of administration of the system." Pet. App. 33a. But the substantive effect of this aspect of Chapter 83 is no different than

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[14] As noted above, the size of the *new* supplemental benefit COLA depends on the availability of funds. Thus, even assuming, contrary to our view, that IDDA and EPDA could have been eliminated, the $1.9 billion could have been used to forestall the possibility of a shortfall resulting from increased inflation.

[15] If this action had been taken, employees would have received benefits associated with larger individual accounts (more money available for early withdrawal as well as higher death benefits). *See* Cal. Gov't Code §§ 20652, 21332, 21360, 21361 (West 1980 & Supp. 1992).

if the "Legislature [had] actually appropriated . . . the PERS trust funds for purposes unrelated to the benefit of PERS members, *e.g.*, to balance the state budget." *Valdes*, 189 Cal. Rptr. at 224. Indeed, if this money had simply been given to charity, employees would have been no worse off: *employer* contributions would have increased, but *employee* benefits (and the funds available to pay them) would have remained unchanged. Surely this reality, and not which bank account the contested money ultimately ended up in, must govern the application of the trust obligation that is a part of the PERS pension contract under California law.[16]

2. The California Court of Appeal's disregard of clear contract rights is equally apparent with respect to Chapter 83's transfer of actuarial responsibility from the PERS Board to an actuary appointed by the Governor. There is no question that employees had a pre-existing statutory right to have the independent PERS Board carry out these functions. Thus, beginning in 1945 and continuously until 1991, the PERS Board was required to assess the value of PERS assets and project the future income and liabilities of the pension program. Cal. Gov't Code §§ 20127, 20130 (West 1980). Based on these assessments and projections, in turn, the Board was then required to determine the magnitude of employer contributions that would, when combined with the fixed employee contributions, produce adequate funding of the system. *Id.* § 20750.9. Such determinations, of course,

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[16] Further betraying its confusion, the court below also asserted that "[t]he use of [this $1.9 billion] to meet the employers' continuing funding obligation is no more proscribed by article XVI, section 17, than is the use of earnings attributable to the *employer* accounts of the PERS fund for the same purpose." Pet. App. 33a (emphasis added). But the contract right at issue here, self-evidently, does not prevent the use of *employer* funds to reduce *employer* obligations; it only bars the use of already dedicated employee funds to pay the employer's obligation to fund a different benefit.

involve a great deal of discretionary judgment. The evident purpose of entrusting them to the carefully balanced PERS Board (*see* p. 5 *supra*) was to assure that basic funding decisions would be insulated from political manipulation by the State, including efforts to minimize current employer costs that might put the pension rights of employees at financial risk.

It is difficult to see how this kind of core structural protection—set forth in unequivocal statutory mandates—could not be considered a contract right. Surely employees would reasonably have viewed this feature of the terms of their employment as an important (and not incidental) element in the package of pension contract benefits. Indeed, the California Court of Appeal itself has previously stated that public employees have a right to those features of the system that assure "the security and integrity of the funds available to pay future benefits." *Valdes*, 189 Cal. Rptr. at 222. The use of the PERS Board to make the decisive actuarial decisions for the pension system obviously falls within this description. *See also California Teachers Ass'n v. Cory*, 202 Cal. Rptr. at 618 ("Pension rights can encompass the funding mechanism for the pension when there is a palpable element of exchange involving funding; continued service as a teacher in return for enhanced assurance that funds to pay the pension benefits will be available at retirement."). The Court of Appeal thus missed the point in concluding that there is "no ground for implying a statutory promise that the duty of performing these [actuarial] functions would not be transferred to another entity." Pet. App. 41a. There *are* grounds for concluding that the duty of performing these functions would not be transferred to another entity not insulated from political manipulation by the State.

The importance of the contractual protection provided by an independent decisionmaker is well illustrated by the facts presented here. The only possible reason for the legislature to reassign these actuarial functions would

have been its conclusion that the PERS Board was setting employer contributions at "too high" a level. Concomitantly, there must have been every expectation that an actuary, appointed through the political process, would find lower levels of employer contributions to be acceptable. That calculus, whatever its justification, can only have a negative impact on the pension rights of PERS members.

Notably, the only decisions that appear to have addressed similar kinds of structural protections in a public employee pension program support the view that they give rise to enforceable contract rights. Thus, in *Sgaglione v. Levitt*, 337 N.E.2d 592 (N.Y. 1975), the New York Court of Appeals held that it was an impairment of contractual rights, unconstitutional under the state constitution, for the legislature to have directed the State Comptroller to invest pension funds in a specific security. The Comptroller was, by statute, the trustee of the pension funds, "vested with discretion to make what he determines to be wise investments." *Id.* at 595. The court concluded that to strip him of the power to make independent decisions was to "remove a safeguard integral to the scheme of maintaining the security of the sources of benefits for over a half century." *Ibid. See also New Hampshire Retirement Sys. v. Sununu*, 489 A.2d 615, 619 (N.H. 1985) (concluding that State law did not authorize the Governor to review the personal service contracts of a public pension board in light of the potential conflict between the board's trust obligations and the Governor's broader concerns).

More recently in *McDermott v. Regan*, 1992 N.Y. Misc. LEXIS 378 (Sup. Ct. Aug. 10, 1992), the court dealt with a situation even closer to that presented here. The New York legislature, in a time of fiscal crisis, had mandated that the Comptroller change the actuarial method used to estimate the future funding needs of the pension system for purposes of determining the current rate of employer contributions. This new method authorized delayed ac-

crual of pension liabilities, thereby allowing the State to suspend its current contributions. Following *Sgaglione*, the court rejected the legislature's imposition of this modification, holding that employees had a contract right to "an independent trustee imbued with the discretion to protect their retirement funds." *Id.* at *9. The contract rights of California's PERS members compel the same conclusion in this case.

III. THIS CASE RAISES ISSUES OF GENERAL IMPORTANCE WARRANTING REVIEW BY THIS COURT.

There are several reasons why this case is appropriate for review by this Court. As we have already demonstrated, the California Court of Appeal's first holding, that financial concerns can justify a State's impairment of its own contracts, conflicts with this Court's precedents, which the court below ignored; and the court's second two holdings, finding no contract rights despite clear statutory mandates, are demonstrably wrong. These rulings, troubling in their own right, also reflect a broader problem of confusion among the state courts concerning the modification of public pension programs.

Thus, in those States where pension statutes are recognized as creating contract rights, there is a clear division between the many courts that have adopted California's elastic "material relation/comparable benefits" standard for modification, *see, e.g., Nevada Employees Ass'n v. Keating*, 903 F.2d 1223, 1227 (9th Cir. 1990); *Burlington Fire Fighters' Ass'n v. City of Burlington*, 543 A.2d 686, 690 (Vt. 1988); *Singer v. City of Topeka*, 607 P.2d 467, 475 (Kan. 1980), and others that require more demanding scrutiny, *see, e.g., Association of Pennsylvania State College & Univ. Faculties v. State Sys. of Higher Educ.*, 479 A.2d 962, 965-66 (Pa. 1984) (comparable new advantages insufficient to justify State's reduction of pension benefits); *Yeazell v. Copins*, 402 P.2d 541, 545 (Ariz. 1965) (existing pension statute may not be unilaterally

modified without consent of current employees). *See generally Wagoner v. Gainer*, 279 S.E.2d 636, 644 (W. Va. 1981) (describing this conflict).[17] In addition, as previously noted (*see* p. 24 *supra*), there is a direct conflict between the decision below and rulings in New York concerning the contractual status of statutory guarantees that funding decisions will be controlled by a specified independent fiduciary.

This confusion should be clarified, and these conflicts resolved, now. This case alone affects the rights of almost a million public employees in California. Beyond that, state and local governments throughout the country are currently engaged in efforts to use public pension funds to ameliorate their fiscal problems. *See* Deutschman, *The Great Pension Robbery*, Fortune, Jan. 13, 1992, at 76 ("In the past two years more than a third of the states have cut or delayed contributions to their pension funds, seized money outright from pension accounts, or begun to debate similar measures."); *see also* Zolkos, *Cash-Hungry States Scare Public Funds: Bulging Coffers Increasingly Seen as Prey*, Pensions & Investments, June 8, 1992; *The Pension Honey Pot*, Financial World, May 12, 1992, at 64; Mahar, *The Great Pension Raid: States and Corporations Hungrily Eye Retirement Nest Eggs*, Barron's, Dec. 2, 1991, at 8. Given this reality, the decision below, unless corrected, plainly has the potential for encouraging an invasion of public pension funds nation-

[17] Yet a third group of decisions holds that statutory guarantees of pension benefits are "gratuities" that create no contractual rights at all, until an employee retires. *See, e.g., Haverstock v. Indiana Pub. Employees Retirement Fund*, 490 N.E.2d 357, 360 (Ind. Ct. App. 1986); *Patterson v. City of Baton Rouge*, 309 So. 2d 306 (La. 1975); *Creps v. Board of Fireman's Relief & Retirement Fund Trustees*, 456 S.W.2d 434, 437 (Tex. Civ. App. 1970). *See generally*, Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 Harv. L. Rev. 992, 993 (1977). California, however, has long recognized the contractual status of public-employee pension benefits. *See, e.g., Allen v. Board of Admin.*, 665 P.2d at 537; *Betts v. Board of Admin.*, 582 P.2d at 617.

wide—a concern strongly confirmed by the extensive *amicus curiae* participation below by public pension programs and affected beneficiaries from several other States and locales.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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Dated: October 16, 1992

APPENDICES

APPENDIX A

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(SACRAMENTO)

C011580

PEGGY J. CLAYPOOL *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

[Filed Mar. 12, 1992]

ORIGINAL PROCEEDING: Application for a writ of mandate. Writ denied.

In this original mandamus proceeding members of the Public Employees' Retirement System (PERS) and their employee organizations (collectively Petitioners), challenge the constitutionality of two parts of chapter 83 of the Statutes of 1991 (Chapter 83). One part repeals three funded supplemental cost of living (Cola) programs and directs that the funds be used to offset contributions otherwise due from PERS employers. The other transfers the responsibility for actuarial determinations from the PERS Board to an actuary acting under a contract with the Governor.

Petitioners and their allies, the nominal respondent Board of Administration of PERS (PERS Board) and amicus curiae, contend that repeal of the supplemental

Cola programs and reallocation of the funds to offset employer contributions unconstitutionally impair the contract rights of PERS beneficiaries and, along with the transfer of actuarial functions, violate California Constitution, article XVI, section 17, which declares that the assets of a public pension or retirement system are trust funds.

The heart of the controversy has two chambers. One concerns the permissible uses of a unique fund within PERS amounting to some two billion dollars. The fund was generated from earnings on the investment of mandatory payroll contributions of employee members of the system. Ordinarily such earnings are accumulated to meet the basic pension obligations of the State and other PERS employers. Some were diverted to fund supplemental Cola benefits to retirees to aid in the preservation of the purchasing power of their pensions. Under Chapter 83 the statutes providing for the supplemental Colas are repealed, a new supplemental Cola program enacted, and the funds reallocated to meet the basic pension obligations of PERS employers.

Petitioners claim that this reallocation of investment earnings impairs the vested contract rights of PERS members. We will conclude that no contract rights are impaired. The principal beneficiaries of the fund, if not reallocated, are former employees who ceased employment prior to the time when an implied statutory promise not to reallocate the fund could have arisen. They earned no vested contract rights under the repealed statutes and must rely, along with present employees, upon a new supplemental Cola program enacted by Chapter 83 as a replacement for the repealed programs. The employees who may have earned vested contract rights by rendering service under the repealed statutes are given comparable advantages under the new supplemental Cola program and for that reason their rights are not unconstitutionally impaired.

The second chamber of the controversy concerns the transfer of PERS Board actuarial functions to an actuary selected by the Governor [the Actuary]. The key issue is whether the assignment of these matters to an outside actuary violates the requirement of California Constitution, article XVI, section 17, that PERS be managed as a trust. We will conclude that Chapter 83 contains safeguards which insulate the Actuary from the control of the Governor and that the transfer of actuarial functions is not facially inconsistent with trust law.

We will deny the petition.

FACTS AND STATUTORY BACKGROUND

The facts for the most part are contained in the history of the Public Employees' Retirement Law and matters subject to judicial notice. (See Valdes v. Cory (1983) 139 Cal.App.3d 773, 780; California Teacher's Association v. Cory (1984) 155 Cal.App.3d 494, 500, fn. 2.) Our point of departure is the opinion of this court in *Valdes* v. *Cory*. There we recounted the history of PERS to March 1982, the date of the enactment challenged in that case. (*Id.* at pp. 780-783.) We will revisit this history before relating subsequent developments. Except as we note, the statutes governing PERS have been substantially carried forward to the present.

A. *PERS History Prior to 1982*

In 1931 the Legislature established the State Employees' Retirement System, presently known as PERS. (Stats. 1931, ch. 700, § 25; Gov. Code, § 20004.)[1] The system included a fund derived from mandatory employee payroll contributions (member contributions), contributions of the state, and earnings on the investment of the fund. (Stats. 1931, ch. 700, §§ 41, 63, 65-74.) The

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[1] References to a section are to the Government Code unless otherwise specified.

member contributions were calculated to provide an average annuity at age 65 equal to one one-hundred-fortieth of a member's final compensation multiplied by the years of service. (*Id.*, § 65.) These contributions were deducted from the payroll of each office or department and the remaining salary payment was declared a full and complete discharge of the obligation owed an employee except for claims of benefits under the retirement law. (*Id.*, § 67.)

The system was administered by a board of administration. At the outset the PERS Board was directed to make actuarial valuations of the fund and the liabilities of the system and to recommend to the Legislature appropriate changes in the rates of contribution to achieve equality between valuation and liabilities. (Stats. 1931, ch. 700, §§ 51, 58, 69-72.)

Each year the PERS Board was to credit member contributions with four percent interest or such greater amount of interest as it deemed proper in light of the earnings on the fund in that year, but no more than actual earnings. (Stats. 1931, ch. 700, § 52.) An individual member account was kept for each member of the retirement system and was credited with the member's payroll contributions and with annual interest. (*Id.*, § 67.) The records and accounts of the PERS Board were directed to show the accumulated contributions of the State. (*Id.*, §§ 56-57.) If a member discontinued employment other than by death or retirement the member was to be paid the amount of his or her accumulated member contributions. (*Id.*, § 75.) A member was entitled to retire at age 60 with 20 years of service and to receive a retirement allowance consisting of an annuity equal to the value of the accumulated employee contributions together with a matching pension funded by the state contributions. (*Id.*, §§ 79-82.)

In 1937 a reserve against deficiencies was created. "Income, of whatever nature, earned on the retirement

fund during any fiscal year, in excess of the interest credited to contributions during said year shall be retained in said fund as a reserve against deficiencies in interest earned in other years, losses under investments, and other contingencies. (Stats. 1937, ch. 806, § 8; see now § 20203.) In 1939 the system was expanded to include any municipal corporation in the State which elected to contract with the PERS Board for coverage of its employees. (Stats. 1939, ch. 927, § 3b.) The law was also amended to provide that interest at the current rate rather than 4 percent should be the baseline credit to member contributions. (*Id.*, § 13.) In 1943 the system was expanded to include any public agency in the State which elected to contract with the PERS Board for coverage of its employees. (Stats. 1943, ch. 640.)

In 1945 the original enactments were repealed but the provisions in essential part were carried over as the State Employees' Retirement Law. (Stats. 1945, ch. 123, §§ 1-2; Gov. Code, §§ 20000-21455.) In 1947 the pension component of the retirement allowance was defined to be the amount, which, when added to the annuity component met prescribed target amounts based on age at retirement and final compensation. (Stats. 1947, ch. 732, § 4.) Under the present version of this provision, for example, a state miscellaneous member retiring at age 60 with 25 years of service is entitled to a retirement allowance of 2 percent of final compensation multiplied by the number of years of service, i.e., half-pay. (§ 21251.13.) This allowance is increased annually by a basic Cola limited to two percent per year. (§§ 21222, 21224.) Some other classifications of members have a higher basic Cola.

In the early years of the system the reserve against deficiencies was not substantial. "For years, the interest credited to accumulated contributions closely paralleled the actual earnings rate after deduction of administrative costs. Until 1971, the crediting rate was usually within one quarter of one percent of the earnings rate. In re-

cent years, however, the crediting rate has not kept pace with market rates of interest, resulting in a dramatic increase in the reserve account because of current record-high investment yields in financial markets. Consequently, the PERS currently [1982] has a reserve approaching $1 billion." (*Valdes* v. *Cory*, supra, 139 Cal. App.3d at p. 783.)

A consequence of the burgeoning reserve for deficiencies was the enactment of section 21231 in 1980. It established a special account within PERS and transferred from the reserve for deficiencies to the account monies exceeding two percent of PERS assets. (*Ibid.*) The purpose of this account was to increase by 10 percent for the period October 1, 1980, through September 30, 1982, the monthly allowance of every person eligible to receive an allowance on December 31, 1979. (*Ibid.*) We adopt the usage of the parties and refer to this benefit as the Boatwright benefit. Subdivision (c) of section 21231 provides that recipients of this benefit are to be informed that "the increases are not cumulative and shall not be included in their base allowance and may be available for only a limited period of time."

In March 1982, chapter 115 was enacted. The provisions of this enactment, challenged in *Valdes* v. *Cory*, directed that employer contributions, payable for a portion of that year, not be paid and that the PERS Board make up the shortfall by transfer of an equivalent sum from the reserve against deficiencies. (Stats. 1982, ch. 115, §§ 14, subd. (b), 58-61.) The PERS Board adopted a resolution declining to make this transfer until compelled so to do by a final judgment of an appellate court. (*Valdes* v. *Cory*, supra, Cal.App.3d at p. 779.) This led to the *Valdes* v. *Cory* litigation.

B. *Chapter 330 of the Statutes of 1982*

In June 1982, chapter 330 was enacted. Section 1 states the legislative intent of the enactment in pertinent part as follows.

> "It is the intent of the Legislature in enacting this act to preserve the actuarial integrity of the Public Employees' Retirement System, to recognize the fiduciary role of the Board of Administration of the Public Employees' Retirement System, to assist in the orderly and equitable disposition of the reserve against deficiencies created by Section 20203 of the Government Code, and to provide for repayment of state and school employer retirement contributions. In enacting this act, the Legislature agrees with the findings of the chief actuary and the board, who, on June 16, 1982, determined that funds in the reserve for deficiencies may be allocated from the reserve without jeopardizing the actuarial soundness of the system. The Legislature also concurs with the board's finding that direct relief from contributions in this time of fiscal stress is for the exclusive benefit of the members and retired members of the system." (*Ibid.*)

Under chapter 330 former section 20203 was amended to provide in pertinent part: "At the end of each fiscal year, the amount in the reserve against deficiencies which exceeds 1 percent of the total assets of the system shall be credited to other accounts as prescribed by this part." (Stats. 1982, ch. 330, § 14.) Chapter 330 also enacted several notable statutes governing PERS. Section 20131.1 requires the PERS Board to credit employer contributions with interest at the current net earnings rate. (Stats. 1982, ch. 330, § 12.) Section 21232 requires the board to transfer $130 million from the reserve for deficiencies to a special account to pay Boatwright benefits for an additional two years. (Stats. 1982, ch. 330, § 29.) The Boatwright benefit has been extended subsequently with pourover funding from the Investment Dividend Disbursement Account, which we next explain. (Stats. 1984, ch. 671, § 1; Stats. 1985, ch. 1495, § 3; Stats. 1988, ch. 1356, § 3.)

Section 21235 requires that the PERS Board establish an Investment Dividend Disbursement Account (Investment Dividend Account) for the purpose of increasing retirement allowances to an amount equal to 75 percent of their original purchasing power. (Stats. 1982, ch. 330, § 30.) The Investment Dividend Account is funded by the residue from earnings after deducting system administration costs, funding the reserve against deficiencies to 1 percent of total assets, and crediting interest to member accounts. (Stats. 1982, ch. 330, § 30.) Member contributions are credited at the current actuarial interest rate. The PERS Board is required to notify recipients of this benefit that "the increases are not cumulative, not part of the base retirement allowance, and may be available for only a limited period of time and that the board may discontinue the increases." (Stats. 1982, ch. 330, § 30.) Chapter 330 also provides that the authorization to pay increased allowances from the Investment Dividend Account under section 21235 was to expire on January 1, 1989. (Stats. 1982, ch. 330, § 30.)

C. *Chapter 1356 of the Statutes of 1988*

Statutes of 1988, chapter 1356 reconfigured the Investment Dividend Account program. Section 20203 was amended to reduce the maximum size of the reserve against deficiencies to 0.30 percent of system assets. The Investment Dividend Account was set at a fixed amount and drew interest at the rate used to credit retired member reserves. (§ 21237.) The remaining funds available under the allocation formula of section 21235 were retained in so called Purchasing Power Accounts. (§ 21237.) The funds in these accounts were used to pay Boatwright benefits and other purchasing power benefits. (§§ 21235-21236.) The Investment Dividend Account supplemented the Purchasing Power Accounts to pay these benefits. (§ 21235.)

Chapter 1356 also established the Extraordinary Performance Dividend Account (Extraordinary Perform-

ance Account). Section 21238 permitted the PERS Board, in years in which the 75 percent of purchasing power goal was met by payments from the Purchasing Power Accounts, to raise pensions to a higher common minimum purchasing power level. The first payment from the Extraordinary Performance Account occurred in January 1991 and under the policies adopted by the PERS Board brought all allowances up to 80 percent of original purchasing power. Payments under this program were paid by a separate warrant and recipients were notified "that the payments are not cumulative, not part of the base retirement allowance, and may be available only as a result of extraordinary investment returns to the system." (§ 21238.)

The Extraordinary Performance Account was funded by pourover funds from the Purchasing Power Accounts consisting of the amount, not to exceed the amount disbursed in the preceding fiscal year, remaining after disbursements were credited to retired member accounts from any funds in excess of those disbursed pursuant to sections 21235 and 21236 for Boatwright and purchasing power allowances in the four preceding years. (§ 21237, subd. (b).) Petitioners concede that the funds, credited to refund member accounts, became employer assets, since they were available to make up part of the ordinary retirement allowance.

D. *Chapter 83 of the Statutes of 1991*

That brings us to Chapter 83 of the Statutes of 1991, which is the subject of Petitioners' challenge. This enactment repeals the statutes providing for the Boatwright benefit, the 75 percent of purchasing power floor, and the Extraordinary Performance Account benefit (collectively former supplemental Colas). (Stats. 1991, ch. 83, §§ 35, 37, 39, 40.) The funds allocated for these benefits are to be used to "reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted." (§ 20131.01.)

In place of the repealed programs section 21235.5 enacts an alternative Cola program, as follows.

> "(a) On an annual basis, the board shall transfer the lesser of: (1) the amount necessary to increase all monthly allowances paid by the system to 75 percent of the purchasing power of the initial monthly allowances; or (2) up to 1.1 percent of the net earnings on member contributions, as determined by Section 20132.6, to a supplemental account.
>
> "(b) The funds so transferred to the supplemental account shall be utilized to increase all monthly allowances paid by the system up to a maximum of 75 percent of the purchasing power, as determined by the actuary, of the initial monthly allowances that were received by every retired person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. Funds remaining in the account after the payment of benefits under this section shall be transferred to the employer accounts. (Stats. 1991, ch. 83, § 36.)

Chapter 83 also transfers many of the actuarial duties previously assigned to the PERS Board to the Actuary. Section 20006 provides:

> "(a) 'Actuary' means an individual or firm practicing as an enrolled consulting actuary appointed by the Governor under contract with the Governor's Office. The contract shall not be subject to any provisions of law relating to competitive bidding. The contract shall be for a fixed period of time not to exceed three years as determined by the Governor. The compensation paid to the actuary and other necessary employees of the actuary shall be fixed by the contract. The actuary under contract with the Governor's Office pursuant to this section may not be awarded a successive contract. All costs of the con-

tract for the actuary shall be paid from the retirement fund on an annual basis. In carrying out duties under this part, the actuary shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution.

"(b) The Governor shall submit the name of the actuary to each house of the Legislature. The actuary shall commence serving in office on the day after receipt of confirmation by both houses of the Legislature. However, the appointment shall become effective and be deemed confirmed the 61st calendar day after the submission of the nomination unless a majority of either house affirmatively rejects the nomination. If the 60-day period ends during a recess of the Legislature, the period is extended to the sixth day following the date on which the Legislature reconvenes." (Stats. 1991, ch. 83, § 5.)

Under the statutes enacted by Chapter 83 the Actuary, among other things, values the liabilities and assets of PERS (§ 20006.1), adopts the annual interest rate and the actuarial interest rate (§§ 20026.1, 20026.2), and determines the employer contribution rates (§ 20750.905).

Additional facts will be introduced at appropriate points in the discussion of the contentions made by the parties.

DISCUSSION

Introduction

We address the most forceful of the arguments advanced by Petitioners and their allies, the PERS Board and the numerous amici, without separate attribution.[2]

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[2] Petitioners have expressly adopted and incorporated the arguments of their allies.

In the voluminous briefings there are numerous arguments which we will not relate or discuss. Many of them are addressed to the wisdom of Chapter 83, a topic outside our purview. (See, e.g., *Valdes* v. *Cory*, *supra*, 139 Cal.App.3d at p. 780.) Other arguments are simply overtaken or outflanked by resolution of the matters which we do discuss or do not warrant discussion because they are too fragmentary or obscure. (See 9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, § 479.)

Petitioners and their allies challenge the validity of the repeal of the former supplemental Cola programs and the reallocation of the monies made available thereby to offset the payment obligations of PERS employers. They claim that all members of the retirement system have contractual rights to the benefits of the repealed programs which have been unconstitutionally impaired by their repeal and replacement by a Cola program which does not provide comparable benefits. Failing that argument they claim that the monies which funded the repealed programs are held in trust for PERS members and cannot be used to offset the obligations of PERS employers. They also challenge the transfer of the PERS Board actuarial duties to an actuary selected by the Governor. We will answer these claims in the following ways.

We begin by assuming that the statutes which created the former supplemental Colas establish contractual rights which may not be altered except by replacement with a program establishing comparable benefits. Our assumption does not extend to PERS members who retired prior to the effective dates of the former programs because they did not exchange their labors for the benefits created after retirement and for that reason gained no vested contractual rights to them. This circumstance affects the comparability of the new Cola program because the former employees are the principal beneficiaries of the repealed programs.

A significant feature of the repealed programs is that their benefits were limited by the amounts in the fund out of which they were to be paid. If the funds declined so did the benefits which they funded. A significant provision of Chapter 83 is that it creates a "second tier" of pension benefits for new employees, who do not make member contributions. The validity of that provision determines whether the new Cola program provides benefits which are comparable to those afforded under the repealed supplemental Cola programs. Since the repealed and new Cola programs must be similarly judged the benefits provided by the repealed programs must be viewed as if modified by the creation of a second tier of non-contributory employees. So viewed, the fund out of which the former supplemental Colas would have been paid would have ceased to grow and would have been largely consumed by payments to retired members lacking vested contractual rights to the benefits paid by the fund. We determine that the Legislature could validly amend the statutes governing PERS by the addition of a second tier of noncontributory employees, the effect of which would have been to erase the benefits to members with vested rights in the former supplemental Cola programs. For that reason the new Cola program provides an obvious new advantage for such members, actual benefits for the theoretical but illusory higher benefits under the repealed programs.

Petitioners and their allies nonetheless argue that because the fund made available by the repeal of the former supplemental Cola programs is held in trust for the benefit of PERS members it may not be used to defray employer contributions which otherwise would be required. We conclude that although the fund must be committed to the payment of PERS trust benefits, since the repeal of the former supplemental Cola programs makes available monies not previously counted toward the actuarial soundness of the trust fund, they may be counted so as to offset PERS employer obligations until employer

contributions are again required for actuarial soundness. Counted in this manner the funds remain committed to the payment of PERS trust benefits.

Petitioners and their allies claim that the provisions of section 20006, which transfer the PERS Board actuarial duties to an actuary selected by the Governor, violate article XVI, section 17 of the California Constitution which declares that PERS assets are trust assets. They assert, and we assume, that this provision constitutionalizes the law of trusts. Section 20006 provides that the Actuary must "assume the fiduciary obligations . . . previously held by members of the [PERS] board, including . . . those set forth in Section 17 of Article XVI of the California Constitution." (§ 20006, subd. (a).) Because Petitioners challenge the validity of section 20006 on its face we are constrained by the limited scope of judicial review appropriate to such a challenge to rule out conjecture predicated upon hypothetical applications of the statute. We will conclude that there is nothing in section 20006 which facially precludes the Actuary from complying with its direction to comply with the "fiduciary obligations [imposed by] Section 17 of Article XVI of the California Constitution."

I

The Repeal of the Former Supplemental Cola Statutes Does Not Impair Vested Rights of Contract

Petitioners challenge the reallocation of the funds committed to the former supplemental Cola programs to defray PERS employer funding obligations. We first address the predicate contention that the repeal of the statutes establishing the former supplemental Cola programs unconstitutionally impairs rights of contract. If that contention is successful the remaining claims are moot. If the repeal of these statutes is invalid the funds allocated to the former supplemental Colas are not available to defray the employer funding obligations.

The basic doctrines governing pension rights are set out in the following passage from Betts v. Board of Administration (1978) 21 Cal.3d 859.

> "A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance of employment. Such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing public entity. The employee does not obtain, prior to retirement, any absolute right to fixed or specific benefits, and only to a 'substantial or reasonable pension' . . . .
>
> " . . . 'An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.' (*Id.* at pp. 863-864, citations and italics omitted; also see Annot., Vested Right of Pensioner to Pension (1957) 52 A.L.R.2d 437, 444-450 for a synopsis of California case law.)

A. *Only Persons Employed After January 1, 1989 Could Have Vested Rights to Former Cola Benefits*

Petitioners and the Governor join issue on the question whether the former supplemental Colas vest contract rights to pension benefits in *anyone* within the meaning of *Betts*. The Governor claims that the peculiar character of these programs distinguishes them from the

statutory entitlements which were the subject of the cases in which the vesting rule developed. He relies upon two primary considerations: (1) that the benefits are expressly conditioned upon the sufficiency of a fund for which there is no promise of actuarial soundness and, (2) that the former supplemental Cola statutes contain admonishments to recipients that future benefit payments are not assured. Petitioners reply that the fact that benefits are subject to a condition only limits vesting to the circumstances addressed by the condition and that the admonitions only inform the beneficiaries of the condition.

At the outset it is useful to resolve a subordinate vesting question, whether members who ceased employment prior to the enactment of the former supplemental Colas have vested rights in their continuance. Petitioners' initial arguments fuse the interests of these members (former employees) with those employed after their effective dates (present employees).

The contractual basis of a pension right is the exchange of an employee's services for the pension right offered by the statute. (See, e.g., California State Teachers Association v. Cory, supra, 155 Cal.App.3d at p. 506). A member whose employment terminated before enactment of a statute offering additional benefits does not exchange services for the right to the benefits. We asked the parties whether these former employees have vested rights.

Petitioners first claim that once new pension benefits are made applicable to retired persons they may not be taken away, relying upon Terry v. City of Berkeley (1953) 41 Cal.2d 698, 702 and Wallace v. City of Fresno (1954) 42 Cal.2d 180. The cases are inapposite. *Terry* did not address the question. It concerned the construction of ambiguous language in a pension ordinance applicable at the time the plaintiff retired for a physical disability incurred in the line of duty. (*Id.* at p. 699.)

The court construed the language in favor of the retiree, holding that an attempt to cure the ambiguity by an amendment of the ordinance "more than four years after the plaintiff retired" was ineffectual. (*Id.* at pp. 702-703.) For the same reason *Wallace* is inapposite. It addressed the reasonableness-"of an amendment [to the employee's pension plan], made before [the] employee is eligible to retire, which provides for termination of pension rights if he is convicted of a felony after retirement." (*Id.* at p. 184.)

Petitioners' remaining claim of direct support rests on Olson v. Cory (1980) 27 Cal.3d 532. At issue was the validity of the repeal of a statute which resulted in a full Cola for judicial pensioners who had retired before the statute was enacted. The court held that the repeal of the statute was invalid regardless whether the pensioners had earned a vested right in the full Cola by service after its enactment. Petitioners conclude therefrom that benefits given retirees after retirement cannot be reduced regardless whether they earned vested rights to them. Petitioners misread the case.

The holding is predicated upon a vested contract right which the retired member did hold. The right was earned not by service under the Cola statute but by service under a statute which measured retirement rights as a percentage of the salary of the judge's successor in office. If the successor had vested rights to a full cost of living adjustment in salary by service after its enactment the pensioner obtained a vested right to a percentage of that salary by virtue of the statute in effect at the time of retirement. The court said: "*Contractually*, each judicial pensioner is entitled to some fixed percentage of the salary payable to the [successor] judge . . . . The resolution of pensioner *vested* rights, then, is dependent on the foregoing resolution of [the successor] judges' vested rights . . . ." (Olson v. Cory, supra, 27 Cal.3d at pp. 541-542, emphasis added.) Since the successor judges earned

vested rights to the salary called for under the full Cola salary statute, the pensioners' vested contract right to a percentage of that salary rendered its repeal invalid as to them.

Olson v. *Cory* does not aid Petitioners because the pension rights of PERS members are not tied to their successors' salary. For that reason employees who ended their service prior to the enactment of the former supplemental Cola statutes have no vested right which could be impaired by their repeal. (See 27 Cal.3d at p. 542; Pasadena Police Officers Assn. v. City of Pasadena (1983) 147 Cal.App.3d 695, 706; York Paid Firemens Pension Fund Board of York City v. Lindsey (Pa. Cmwlth. 1980) 415 A.2d 441.)

That brings us to Petitioners' claim that former employees obtained a vested right to continuance of the former supplemental Colas because they exchanged another vested right for them. Petitioners suggest that this is a case like *Pasadena Police Officers Assn.*, *supra*, which held that employees were entitled to the continuation of a Cola based upon such an exchange. In that case the retirees had earned a contractually vested right to a fixed pension which could not be reduced. A post employment amendment of the pension ordinance offered these retired employees an option to exchange that vested right for a pension measured by a Cola having the potential of increasing or decreasing the pension by a cost of living adjustment. The court held that retirees who elected the Cola provision were protected from repeal of the amendment because their post employment election to exchange benefits created a contract that could not be impaired.

Petitioners argue that former state employees are in an analogous situation because the statutes establishing the former supplemental Colas funded them by reduction of the reserve against deficiencies from 1 percent of

PERS assets to 0.30 percent of PERS assets. They claim that the former employees had a vested contract right to a reserve account of 1 percent of PERS assets under our holding in *Valdes* v. *Cory* and suggest that the only manner in which the reduction of the reserve account could have passed constitutional muster is on the theory the pension rights were reasonably modified pursuant to the criteria in *Betts*. They claim that the former supplemental Colas were the comparable new advantage required to offset the disadvantage of reduction of the reserve account.

The analogy to *Pasadena Police Officers Assn.* is inapposite. The former employees made no election (acceptance) of an alternative pension right offered by the employer. No new contract was formed by an exchange. Their claim of right must be founded upon the antecedent contract, entered into prior to retirement, or they have none. As we will show (§ *II*, *post.*, pp. 34-39 [typed opinion]), *Valdes* does not hold that there is a vested contract right to a reserve account of 1 percent of system assets. Moreover, retirees, unlike employees, are not subject to the reasonable modification doctrine. (See e.g., *Terry*, 41 Cal.2d at pp. 702-703; *Betts*, 21 Cal.3d at pp. 864-865.) If their contracts had been impaired by the reduction of the reserve account their remedy was a timely action to avert or halt the impairment.

The only arguable claims of vested contractual rights pertain to present employees, members employed after Statutes of 1988, chapter 1356 reconfigured the Investment Dividend Account program. Prior to that enactment the former supplemental Cola programs were subject to expiration by sunset provisions. (See, e.g., Stats. 1982, ch. 330, § 29.) The elapsed period between these enactments and their sunset dates are such that employees who worked under them would not have reached eligibility for payment of supplemental Cola benefits prior to their expiration.

B. *Reasonable Modification*

We need not reach the issue whether members employed after January 1, 1989, are entitled to vested contractual rights in the former supplemental Cola programs. Under California law an " 'employee's vested contractual pension rights may be modified prior to retirement [provided that the] modifications must be reasonable . . . .' " (*Betts, supra*, 21 Cal.3d at p. 864.) Because it poses novel constitutional questions, the resolution of the question of vested rights is more problematic than resolution of the question whether Chapter 83 is a reasonable modification of the prior supplemental Cola programs. If we resolved the vesting question in favor of Petitioners we would nonetheless have to address this latter question. Since constitutional adjudication is eschewed where possible (E.g., Cumero v. Public Employment Relations Bd. (1989) 49 Cal.3d 575, 586) we will proceed to the question of reasonable modification, assuming for the sake of discussion that Petitioners would prevail on the vesting question as to persons employed after January 1, 1989.

1. *The Changes In The Supplemental Colas Bear a Material Relation to the Theory of PERS*

Under *Betts* a modification of a vested pension right is reasonable only if it "bear[s] some material relation to the theory of a pension system and its successful operation, and changes in [it] which result in disadvantage to employees [are] accompanied by comparable new advantages." (21 Cal.3d at pp. 864-865.)

Petitioners first argue that the new supplemental Cola program lacks the requisite relation to the theory of the pension system and its successful operation because the purpose of the enactment is to alleviate a state budget deficit. The Governor argues that the changes provide a more certain source of long term funding for the supplemental Cola benefits as well as alleviating a deficit.

Petitioners suggest that the material relation requirement renders changes made with a purpose of saving the public employer money invalid per se. We disagree.

The saving of public employer money is not an illicit purpose if changes in the pension program are accompanied by comparable new advantages to the employee. If that were not the case the reasonable modification doctrine would add little flexibility to the administration of the public pension systems. The "material relation" requirement fulfills "the purpose of keeping the pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system . . . ." (See Wallace v. City of Fresno, supra, 42 Cal.2d at pp. 184-185.)

The case law which applies the "material relation" requirement is sparse. *Wallace* held that an amendment which terminated all pension rights of a pensioner upon conviction of a felony after retirement did not satisfy that requirement. (42 Cal.2d at p. 185.) "[T]he change was designed to benefit the city and . . . to meet the objections of taxpayers who would be opposed to contributing funds for the maintenance of a pensioner who had been convicted of a felony." (*Ibid.*) In Allen v. City of Long Beach (1955) 45 Cal.2d 128, 133, it was held that amendments which increased the employee contribution rate, providing for a fixed pension and requiring a contribution from employees returning from military service, did not bear a relation to the functioning and integrity of the pension system. The City did not claim that the changes were necessary to preserve or protect the pension program or that otherwise it would have difficulty in meeting its pension obligations. (*Ibid.*) It claimed that newer employees, not eligible for the original pension rights, were disgruntled and that to remedy that condition it wished to equalize the compensation of the two groups of employees. (*Ibid.*)

Wallace and *Allen* show that considerations external to the functioning of the pension system, such as increased

taxpayer hostility to felons or jealousy of employees not covered by the system will not justify a change. The justification must relate to considerations internal to the pension system, e.g., its preservation or protection or the advancement of the ability of the employer to meet its pension obligations. Changes made to effect economies and save the employer money do "bear some material relation to the theory of a pension system and its successful operation . . . ." (Betts v. Bd. of Administration, supra, 21 Cal.3d at p. 864.) That is not to say that a purpose to save the employer money is a sufficient justification for change. The change must be otherwise lawful and must provide comparable advantages to the employees whose contract rights are modified. We hold only that the monetary objective will not invalidate a modification which is otherwise valid.

2. *Unless the Second Tier Provision is Invalid the New Supplemental Cola Provides A Comparable Advantage In Lieu of the Disadvantage of Lower Maximum Benefits*

Petitioners locate the disadvantage in the lowered purchasing power maximums for the new supplemental Cola benefits under section 21235.5. As we next show, the claim fails unless the provision of Chapter 83 which requires that certain state employees hired after the effective date of the statute be placed in a noncontributory pension plan (mandatory second tier) is invalid.

Under the former supplemental Cola programs retirees eligible for Boatwright benefits could receive more than 75 percent of the original purchasing power of their pensions and all retirees could receive more than that level under the Extraordinary Performance Account program. Under new section 21235.5 the maximum level of purchasing power protection is 75 percent. Petitioners originally argued that this is a disadvantage for which

there is no offsetting comparable advantage. The Governor replied that comparability does not require point by point equality and suggested that the potential for greater benefits under the repealed statutes is offset by the greater assurance of funding under section 21235.5.

The Governor adduced an independent actuarial report [the Foster-Higgins report], provided to PERS on January 15, 1991, under a contract authorized by former section 20234.[3] He argues that it shows that the accumulated former supplemental Cola funds would have been exhausted in about a decade and that the annual funding mechanism for that program is less reliable and productive than the annual funding mechanism under the new supplemental Cola. The Petitioners challenge both the interpretation and methodology of the report.

The Petitioners adduced expert actuarial opinion testimony supporting the conclusion that if the former supplemental Cola program had continued and had been operated under past policies, its annual funding mechanism would have been more productive than the funding mechanism under the new supplemental Cola. The Governor replied with contrary expert actuarial opinion.

As we have shown, the reasonableness of the modification must be viewed from the vantage point of persons employed on or after January 1, 1989. That has significant consequences for Petitioners' original arguments.

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[3] Former section 20234 (Stats. 1982, ch. 1496, § 5; repealed Stats. 1991, ch. 83, § 26) is as follows. "The board shall annually contract with an independent actuary to analyze and comment on the application of generally accepted actuarial practices to the actuarial assumptions utilized by the board during the preceding fiscal year and the effect of the benefit provided by Section 21235 on employer contribution rates. [¶] A copy of the report shall be filed with each house of the Legislature, the chairman of each affected policy committee, and the Governor at the same time as the report required by Section 20136."

Boatwright benefits were available only to persons whose employment terminated prior to the enactment of the program. Therefore no one has vested rights in it.

The loss of the potentially higher level of benefits under the Extraordinary Performance Account program is a disadvantage, but that potential must be evaluated by its actuarial consequences. A person employed on January 1, 1989, was not entitled to receive Extraordinary Performance Account benefits (as the program was administered by PERS) until retirement and erosion of the pension's value to 80 percent of its original purchasing power. That would not occur until nine years after the date of retirement, assuming a 5 per cent inflation rate and a basic Cola of 2 percent. For that reason the comparability of the new supplemental Colas to those under the Extraordinary Performance Account must be gauged by the benefits which would accrue for the period beginning in 1998 and extending over the likely duration of their receipt.

In light of this measure of comparability and the conflicting opinion testimony we asked the parties to compare the projected benefits of a typical, hypothetical present employee under the former and new supplemental Cola programs. Because Chapter 83 has a mandatory second tier under which new employees would make no member contributions we asked the parties to factor the absence of such contributions into their calculations of projected benefits under *both* supplemental Cola programs.

The parties adduced evidence in response to our request. The Governor adduced evidence of projected benefits predicated upon a mandatory second tier. This evidence shows that the projected new benefits are likely to be equivalent to or greater than those available under the former program. The Petitioners declined to compare projected benefits on the assumption of a mandatory second tier applicable to the former supplemental

Cola programs.[4] They argue that the comparison would be misleading. "The very reason that the [new supplemental Cola] Program fails, when compared to the [former supplemental Cola] Program, is that the [new supplemental Cola] Program is accompanied by a mandatory second tier, while the [former supplemental Cola] program was not."

It is apparent that Petitioners' claim of unreasonable modification succeeds only if the mandatory second tier is invalid if applied to the former supplemental Cola programs. Unless the second tier is invalid the new supplemental Cola program provides an obvious new advantage for present employees, actual benefits for the theoretical but illusory higher Extraordinary Performance Account benefits. Accordingly, Petitioners' contention that the repeal of the former supplemental Colas is invalid fails unless the addition of a mandatory second tier provision is infirm.

3. *A Mandatory Second Tier Provision Does Not Unconstitutionally Impair Rights of Contract*

Petitioners, apprehending the foregoing implication, now contend that a mandatory second tier provision impairs vested contract rights under the former supplemental Cola statutes because of its derivative impact upon benefits under those programs. They argue, without benefit of legal support, that since a mandatory second tier provision would ultimately cause benefits under the former supplemental Colas to fall short of the maximum

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[4] The PERS Board also provided sketchy evidence regarding the comparability of benefits in response to our request. That evidence tends to show that "[a]s long as there are sufficient funds to pay [former supplemental Cola] benefits, those payments are larger than the payments provided by [Chapter 83]." However, that begs the question of the effect of a second tier upon the continued availability of funds to pay the supplemental Cola benefits. The PERS Board failed to address that question.

levels called for "it destroys the vested [former supplemental Cola] benefit." The argument assumes the answer. The appropriate question is whether there is a vested contract right under the former supplemental Cola statutes to continued contributions by new employees which is impaired by a statute which places new employees in a noncontributory pension program.

Unlike most statutes providing for pension benefits the former supplemental Cola statutes offer benefits which are expressly predicated upon the availability of moneys in the fund from which they are to be drawn. (§§ 21235-21236; Stats. 1988, ch. 1356.) There is no right to their payment if the fund is insufficient to fund the benefits. (See Bellus v. City of Eureka (1968) 69 Cal.2d 336, 352.) The question then arises whether the statutory scheme establishing the former supplemental Colas contains an express or implied promise that the Legislature will not change the nature of the pension system as to future employees if that would have a detrimental impact on the fund from which the former supplemental Colas were to be paid. (See California Teacher's Association v. Cory, supra, 155 Cal.App.3d at pp. 504-506.)

There is no such promise in the statutory scheme either express or implied. The express dependence of the former supplemental Cola benefits upon the prescribed funding scheme belies an assurance that the benefit targets are promises. A promise not to change the character of a pension program as to new employees is a fundamental constraint on the freedom of action of the Legislature. There is no such promise expressed in the statutes and we will not imply one. "Future employees do not have a vested right in any particular pension plan (*Estes* v. *City of Richmond* [(1967) 249 Cal.App.2d 538], pp. 544-545.) And, although active and retired members have a vested right to a pension, they do not have a vested right to control the administration of the plan which

provides for the payment of pensions." (Whitmire v. City of Eureka (1972) 29 Cal.App.3d 28, 34.)

This court implied contractual obligations in *Valdes* v. *Cory* and *California Teacher's Association* v. *Cory* which constrained the administration of PERS and the Teachers' Retirement Fund. We did so on the strength of assurances to be found in the language of the governing statutes. In both cases the statutes showed a "commitment to permanency" of funding of "critical importance" to the "underlying contractual promise to pay the pensions . . . ." (*California Teacher's Assoc.* v. *Cory*, *supra*, 155 Cal.App.3d at p. 506.) We noted that the implication of suspension of legislative control must be "unmistakable." (*Id.* at p. 509.) The implication Petitioners urge here falls short of that requirement.

Had the mandatory second tier been enacted independently of the new Cola program its impact upon the funding of the former supplemental Colas would furnish no cause of action. For that reason the mandatory second tier must be taken into account in evaluating the comparative value of the new supplemental Cola. As we have explained, that renders nonmeritorious Petitioners' contention that the new supplemental Cola is not a reasonable modification as to the employees who may have vested contract rights.

The repeal of the former supplemental Cola statutes effected by Chapter 83 is valid.

II

The Use of Funds From the Former Supplemental Cola Programs to Offset Employer Contributions Does Not Impair Funding Rights Identified in Valdes v. Cory

Petitioners contend that in any event the use of the fund made available by the repeal of the former supplemental Cola programs to defray employer contributions

to the PERS fund impairs vested contract rights to funding which we identified in *Valdes* v. *Cory*, *supra*.

What we said in *Valdes* v. *Cory*, to which Petitioners point, rests upon "the nature of the reserve against deficiencies." (139 Cal.App.3d at p. 788.) That fund is statutorily allocated to meet contingencies that could impair the actuarial soundness of the PERS fund. In this case, the *valid* repeal of the former supplemental Cola programs has created a unique fund of a critically different nature. These monies were not previously counted toward the actuarial soundness of PERS, were not reserved to underwrite the actuarial soundness of the basic pension benefits, and are not now tied to the provision of any special benefits required to be paid.[5] Shorn of its relation to the benefits provided under the former supplemental Cola programs, the fund is available to back the actuarial soundness of the PERS system and may be applied to offset the employer contributions that would otherwise be required to that end.

Petitioners rely upon the portion of *Valdes* v. *Cory* which rejects the argument that the state had not defaulted in its continuing obligation to make monthly payments to the PERS fund by merely changing the source of the contributions from the general fund to the PERS reserve against deficiencies. (139 Cal.App.3d at pp. 787-

[5] For this reason petitioners' argument that permitting consideration of the former supplemental Cola funds to offset employer contributions will establish a precedent for future expropriation of other PERS funds is ill-founded. Petitioners' alarm is apparently based upon the addition of the following underlined language in an amendment of section 20203.3. "Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, *the reduction of employer contributions*, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries." Whatever the purpose of the amendment, it cannot overrule *Valdes* v. *Cory*.

790.) In this passage we considered the argument of the Director of Finance that the State met its continuing obligation to make monthly payments from the PERS reserve against deficiencies. (*Id.* at p. 787.) We rejected the argument on the ground that it "misconceives the nature of the reserve against deficiencies." (*Id.* at p. 788.)

Petitioners submit that the passage forbids the use of any PERS fund of whatever nature to offset an otherwise required employer contribution. To the extent that the language in *Valdes* v. *Cory* is susceptible to this reading it addresses matters not in issue in that case. The preservation of the actuarial soundness of PERS entails a comparison of the funds available to meet its financial obligations with the obligations. If for some lawful reason the existing PERS funds are demonstrably sufficient for actuarial soundness without the state's periodic contribution, the Legislature may forego the contribution without violating the holding in *Valdes* v. *Cory*. (See 139 Cal. App.3d at p. 787.)

Funds may be counted only once to determine the amount of the employer contribution necessary to keep the system in actuarial trim. In keeping with *Valdes* v. *Cory*, funds in a reserve account which are dedicated to backstopping the integrity of the system against unexpected contingencies may not be used to offset the employers' obligations to contribute to the actuarial soundness of the system unless there is a predicate showing that their use will not undermine the financial integrity of the system.

Petitioners claim that *Valdes* v. *Cory* prohibits the offset here because, as in that case, Chapter 83 was enacted "without any *actuarial* input or recommendation from the Board, as directed by former section 20750.9, that contributions could or should be eliminated." The argument is unpersuasive because, unlike *Valdes* v. *Cory*,

an appropriate actuarial predicate existed prior to the enactment of Chapter 83.

In *Valdes* v. *Cory* we discerned in the statutes which imposed actuarial duties upon the PERS Board a requirement that periodic employer contributions not be altered "absent actuarial input from the board in a timely manner." (139 Cal.App.3d at p. 787.) The evidence we considered did not show whether the transfer of funds from the reserve against deficiencies would undermine the security of members' rights to receive vested benefits.[6] The failure of the State to meet its burden to demonstrate the absence of such an impact accounts for our rejection of its arguments, both those considered in the opinion and those rejected without discussion.

In this case, the monies which initially funded the former supplemental Colas were obtained from the reserve against deficiencies pursuant to a finding by the PERS Board that the money could be so allocated *without* jeopardizing the actuarial soundness of the system. "In enacting this act, the Legislature agrees with the findings of the chief actuary and the board, who, on June 16, 1982, determined that funds in the reserve for deficiencies may be allocated from the reserve without jeopardizing the actuarial soundness of the system."

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[6] At the outset of *Valdes* v. *Cory* we ascertained that PERS is intended to be maintained on a sound actuarial basis and that such a transfer of funds impaired the member's contract rights in such a fund. (139 Cal.App.3d at pp. 785-786.) We then said: "[h]aving delivered ourselves of this dictum we confess that the record before us is woefully incomplete and inadequate as a basis upon which to determine whether the disputed provisions of chapter 115 do in fact impair the actuarial soundness of the PERS. [Citations.] [¶] We ***therefore*** turn to consideration of the contention that the state has a statutorily created contractual obligation, impaired by operation of chapter 115, to make systematic, substantial monthly contributions to the PERS fund in order to fund pension benefits as liability therefor is incurred." (*Id.* at p. 786, emphasis added.) The subsequent analysis rests upon this state of the record.

(Stats. 1982, ch. 330, § 1.) The subsequent allocations of earnings on employee contributions to the former supplemental Cola funds were accomplished, with the apparent acquiescence of the PERS Board, pursuant to statutes which were not challenged as actuarially unsound when enacted.

The Legislature was entitled to view this allocation of monies to fund the former supplemental Colas as not undermining the security of members' rights to receive their basic pension benefits. Unlike the reserve against deficiencies the former supplemental Cola funds were not allocated to backstop the basic pension benefit promises. Since the funds were not counted toward the maintenance of the actuarial soundness of the PERS fund or allocated to cover contingencies that could impair actuarial soundness they are logically immaterial to actuarial soundness. Their use to offset employer contributions that would otherwise be required to be made is not prohibited by the holding in *Valdes* v. *Cory*.

III

The Use of Former Supplemental Cola Funds To Reduce Employer Contributions Otherwise Required Does Not Unconstitutionally Invade the PERS Trust

Petitioners contend that the use of the former supplemental Cola funds to reduce employer contributions violates California Constitution, article XVI, section 17.[7]

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[7] California Constitution, article XVI, section 17, in pertinent part is as follows.

"....

"Notwithstanding provisions to the contrary in this section and Section 6 of Article XVI, the Legislature may authorize the investment of moneys of any public pension or retirement system, subject to all of the following:

"(a) The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and

The thrust of the argument is that since the assets of the system are declared in that section to be "trust funds" which "shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system" they cannot be used to defray the employers' funding obligation. The answer to this argument is that the money has not been diverted from the system and is to be used for the purposes authorized by the California Constitution.[8]

The language of article XVI, section 17, upon which Petitioners rely, was enacted by an amendment of June 5, 1984. The ballot arguments of the proponents of the measure asserted that the measure would "give public pension assets full constitutional protection as trust funds" and "guarantee[] that neither the Governor nor future Legislatures will ever be able to use this money for other purposes." (Ballot Pamp., argument in favor of Proposition 21 as presented to the voters, Prim. Elec. (June 5, 1984) p. 26.) The arguments also assert that under the measure "the *only purpose* for which these trust assets

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their beneficiaries and defraying reasonable expenses of administering the system.

"(b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system."

[8] We note parenthetically that the parties argue over the application of subdivision (b) of article XVI, section 17, the topic of a recent opinion of this court in City of Sacramento v. Public Employees Retirement System (1991) 229 Cal.App.3d 1470, 1492-1494. The argument is a digression since the subdivision pertains to the duties of the fiduciary of the public pension or retirement system. This refers to the duties of the trustees and not, save perhaps derivatively when legislating upon that topic, to the duties of the Legislature which are in issue here.

can be used is the delivery of retirement benefits" and that it "[e]nacts the *sole and exclusive purpose rule* which imposes on fund trustees the legal obligation to perform their duties *solely* in the interest of plan beneficiaries." (*Ibid.*, orig. emphasis.)

Neither the trust provisions of article XVI, section 17, nor the statements of its proponents in the ballot argument apply to the action challenged here. The use of the former supplemental Cola funds to reduce the employer contributions otherwise necessary to keep the PERS fund in actuarial trim does not invade the PERS trust. (Cf., e.g., Stats. 1982, ch. 330, § 1, quoted, *ante*, [typed opinion p. 9].) The funds, in the words of the California Constitution, continue to be "held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." The funds, in the words of the ballot argument, will only be used for "the delivery of retirement benefits." They remain PERS assets until they are paid to PERS members or beneficiaries or to defray the costs of administration of the system.

The use of these funds to meet the employers' continuing funding obligation is no more proscribed by article XVI, section 17, than is the use of earnings attributable to the employer accounts of the PERS fund for the same purpose. The contract right to periodic employer funding can only be determined by considering the value of the PERS assets that are available to defray its legal obligations. If this use were barred by the exclusive purpose language of subdivision (a) of article XVI, section 17, the funding obligation would be rendered unintelligible.

For these reasons the contention that the use of the former supplemental Cola funds to reduce employer contributions violates California Constitution, article XVI, section 17, is not meritorious.

IV

The Assignment of PERS Actuarial Duties to an Outside Actuary Is not Unconstitutional

A. *Appointment of the Actuary by the Governor Does not Present an Intolerable Conflict of Interest*

Petitioners challenge other provisions of Chapter 83, which transfer actuarial duties from the PERS Board to an actuary appointed by the Governor, as violating article XVI, section 17 of the California Constitution. As related, it provides that the PERS assets "are trust funds" and the "fiduciary of the . . . system shall discharge his or her duties . . . solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system." Petitioners suggest that these provisions constitutionalize the law of trusts and under that law the Actuary cannot qualify as a fiduciary because Chapter 83 places the Actuary under the control of the Governor and subject thereby to an intolerable conflict of interest precluding a fiduciary relationship with beneficiaries of the PERS trust fund.

Since Petitioners tender a facial challenge to the constitutionality of Chapter 83 we must test the legislation by the fair reach of its terms, avoiding a resolution predicated upon uncertain or contingent future events. "To support a determination of facial unconstitutionality, voiding the [challenged provisions of the] statute as a whole, petitioners cannot prevail by suggesting that in some future hypothetical situation constitutional problems may possibly arise as to the particular *application* of the statute . . . . Rather, petitioners must demonstrate that the act's provisions inevitably pose a present total and fatal conflict with applicable constitutional prohibitions." (Pacific Legal Foundation v. Brown (1981) 29 Cal.3d 168, 180-181, orig. emphasis.) Nonetheless, the amend-

ment of article XVI, section 17, in 1984 requires close judicial scrutiny of changes to the status quo which threaten the trust protection of public employee retirement funds. "[A] major change [wrought by the amendment] was to specify that the trust funds held by a public pension or retirement system are to be administered in a manner to best provide benefits to the participants of the plan. (See, Historical Notes to Cal. Const., art XVI, § 17.) This change gave constitutional significance to the pre-existing statutory mandate that the " 'Public Employees' Retirement Fund is a trust fund created and administered . . ., solely for the benefit of the members and retired members of the system and their survivors and beneficiaries.' (§ 20200.)" (City of Sacramento v. Public Employees Retirement System, supra, 229 Cal. App.3d at p. 1493.)

Government Code section 20006, as enacted by Chapter 83, provides that the Actuary "shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution." We must assume, consistent with our limited scope of review, that the Actuary in carrying out the assigned duties will comply with this mandate.

Section 20006.1 provides that the Actuary shall "make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving benefits", make an "actuarial valuation of the assets and liabilities of this system", and "determine the rate of interest being earned on the Retirement Fund . . . ." [9]

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[9] Section 20006.1 provides: "On an annual basis, no later than December 1 of each year, the actuary shall make an actuarial valuation of the liabilities for benefits under this part on account of employees of the state. As of the effective date of this section, and thereafter at the end of periods not to exceed four years, the actuary shall make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving

Under the prior law these functions were carried out by the PERS Board based upon calculations and advice of actuaries "regularly employed . . . by the [PERS] board or the chief actuary's designee." (Stat. 1979, ch. 1110, § 3, eff. Sept. 28, 1979.)

We will assume that article XVI, section 17, imports the existing law of trusts and that the Actuary must satisfy its requirements for fitness to serve as a trustee. A trustee may be removed by a court for misconduct, unfitness, or acquisition of an adverse interest. (See, e.g., Prob. Code, § 15642; 11 Witkin, Summary of Cal. Law (9th ed. 1990) Trusts, § 55.) Petitioners cite numerous cases in which trustees subject to a conflict of interest have been sanctioned. These cases involve a conflict which resulted in an identified breach of trust. The claim in this case is tendered in the absence of an actual breach of trust. The cases relied upon are therefore inapposite.

There is no precedent in the law of trusts for the circumstance in which a legislature has created the office of actuary and it is claimed that the manner of appointment to the office constitutes a categorical conflict of interest. Ordinarily the Legislature is free to prescribe the law of trusts. Viewing the Legislature in this circumstance as analogous to the settlor of the PERS trust, there is no breach of the trust law. Where a trustee is named by the settlor who is aware of the possible conflicts of interest inherent in the appointment, removal on the ground of conflict of interest is ordinarily unwarranted without an actual breach of trust. (See, e.g., Estate of Gilliland (1977) 73 Cal.App.3d 515, 528; Rest.

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benefits and an actuarial valuation of the assets and liabilities of this system. From time to time, the actuary shall determine the rate of interest being earned on the Retirement Fund after deducting from earnings amounts applied to costs of administration of the system."

2d Trusts, § 107, com. f.[10]) The bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee.

The most forceful of Petitioners' claims of conflict of interest is that under section 20006 (*ante*, at p. 11) the Actuary's contract is subject to termination at the will of the Governor. That is the reading initially adopted by the Governor. His original contract proposal provided for termination of the Actuary's contract on 30 days notice. Section 20006 provides that the contract of appointment "shall be for a fixed period of time not to exceed three years as determined by the Governor." We asked the parties whether termination at will is consistent with this provision. The Governor responded that section 20006 precludes him from terminating the Actuary's contract without just cause during the "fixed" period of the contract and that the contract executed with the Actuary will so provide.

This is our construction of section 20006. The term "fixed period" implies that the contract is not subject to termination at will. (Compare Lab. Code, §§ 2924, 2922.) Section 20006 contains several provisions which minimize the possibility that the Governor might attempt to influence the performance of the Actuary's duties through the power of selection. The Actuary must be an enrolled actuary,[11] the compensation must be fixed by the contract, the Actuary may not be awarded a "successive" con-

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[10] We note the following caveat in Restatement Second of Trusts section 107, comment f: "In such a case [where the trustee seems subject to a conflict], however, the conduct of the trustee in the administration of the trust will be subject to careful scrutiny; and if it appears to the court that because of his interest or otherwise he is unduly favoring himself and not fairly exercising the discretion conferred upon him, the court will remove him as trustee."

[11] An "enrolled actuary" means an actuary enrolled under subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974. (See § 7507.)

tract,[12], must assume the fiduciary obligations formerly assigned to the PERS Board, and the Legislature must approve the choice of the Actuary. (§ 20006.) These provisions underscore the view that the "fixed period" serves a similar purpose. This reading is favored because it minimizes the prospect of an unconstitutional conflict with article XVI, section 17 of the California Constitution. (See Assoc. for Retarded Citizens v. Department of Developmental Services (1985) 38 Cal.3d 384, 394.)

The pertinent question is whether the selection of the Actuary by the Governor under these conditions places the Actuary in a position hopelessly in conflict with the fiduciary obligations imposed by article XVI, section 17. We think not. The safeguards enacted in section 20006 sufficiently insulate the Actuary from control by the Governor so as to permit the Actuary to function as a fiduciary. Those duties are constitutionally prescribed by article XVI, section 17. This implicitly subsumes the principle of trust law that the Actuary's primary duty is to the beneficiaries of the trust. (See City of Sacramento v. Public Employees Retirement System, supra, 229 Cal.App.3d at p. 1494.)

B. *The Law of Trusts Does Not Require That Actuarial and Other Functions Be Performed by the Same Trustees*

Petitioners claim that the transfer of actuarial functions is inconsistent with the law of trusts because the PERS Board trustees cannot administer PERS without the power to control the Actuary. We asked the parties whether a division of trustee functions would be per-

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[12] The term "successive" does not preclude subsequent appointments of the same actuary. Whether this is subject to redress for abuse by manipulation of the frequency and terms of the contracts is an issue we do not reach as it may never arise. As we note in the text, an abuse of the process of selection which impairs the fiduciary obligations of the Actuary is subject to judicial scrutiny.

missible under the law of trusts if we viewed the Actuary and the PERS Board as cotrustees or the Actuary as a special trustee. Petitioners suggest that these doctrines cannot be applied because cotrustees must supervise each other. The Governor replies that nothing in the law of trusts precludes the division of functions resulting from Chapter 83 among cotrustees or special trustees. The Governor has the more persuasive argument.

Petitioners suggest that under California law cotrustees must act unanimously, citing Probate Code section 15620. However, that statute belies the assertion since it merely prescribes unanimity unless otherwise provided in the trust instrument. As the Governor notes, Restatement Second of Trusts section 194, comment d, indicates a general rule that powers can be divided among trustees if it is so provided by the terms of the trust. The comments to section 185 of the Restatement show that discretionary powers may be assigned to nontrustees, who may also be subject to fiduciary obligations.

Petitioners suggest that the division of powers is inconsistent with the law of trusts because it imposes on each trustee the duty to participate in the administration of the trust and to take reasonable steps to prevent or cure a breach of trust by fellow trustees. (See Prob. Code, 16013). It is not a necessary consequence of these obligations that all trustees be given an equal share of the duties or powers accorded by the trust instrument. If that were the case there would be no doctrine of special trustees or holders of special powers.

While there may be legitimate concerns regarding a potential conflict of interest, we cannot assume that the Actuary will not faithfully adhere to the fiduciary obligations imposed upon it. Given their facial challenge Petitioners "cannot prevail by suggesting that in some future hypothetical situation constitutional problems may possibly arise" from the application of Chapter 83. (Pacific

Legal Foundation v. Brown, supra, 29 Cal.3d at p. 180.) Petitioners point to no case law nor doctrine in the law of trusts which can reasonably be applied under the aegis of article XVI, section 17, to categorically bar the Actuary from acting as a fiduciary under a section 20006 contract. If the Actuary violates those obligations Petitioners may seek judicial relief in the manner of all other beneficiaries of a trust.

C. *The Transfer of Actuarial Functions Is Not Invalid On Grounds of Improper Urgency Statute, Impairment of Contract, Denial of Due Process, Or Improper Delegation*

That leaves several less developed claims of invalidity of the transfer of actuarial functions. Petitioners contend that the transfer of functions is founded on a pretextual declaration of urgency, improperly impairs a vested contract right to have the PERS Board perform those functions, denies due process of law, and improperly delegates legislative authority without appropriate safeguards or standards. These claims warrant no extended discussion.

Petitioners suggest that the transfer of function provisions contravene California Constitution, article IV, section 8, subdivision (d), which defines the term "urgency statute." The argument is elliptical and undeveloped except for the claim that the "fiscal emergency" proffered by the Legislature as the grounds of urgency are pretextual. Petitioners cite Sonoma County Organization of Public Employees v. County of Sonoma (1979) 23 Cal.3d 296 in support of the suggestion that this court may freely "look past the bald assertion" of "fiscal emergency." However, that case is inapposite. It addresses the topic of review of a justification for a contract impairment and not the standard applicable to review of a declaration tendered to justify an urgency statute. As the Governor suggests, the latter scope of review is exceedingly limited (e.g., Davis v. County of Los Angeles (1938)

12 Cal.2d 412, 422-423) and Petitioners make no showing invoking such review.

Petitioners suggest that the transfer impairs contract rights of PERS members and of the City of Sacramento, which made a contract with PERS calling for employer contributions "subject to adjustment by [the PERS] Board." These claims are groundless for the reasons given in response to the contention that the mandatory second tier provision impairs a vested contract right. (Discussed in § I(b)(3), *ante.*) There is no ground for implying a statutory promise that the duty of performing these functions would not be transferred to another entity. There is a similar shortcoming in the argument regarding the City of Sacramento. Assuming for the sake of discussion that Petitioners are proper parties to raise purported rights under that contract, the claim is even weaker, since the state has no obligation of payment under that contract. (See, Cal. Teachers' Assn. v. Cory, supra, 155 Cal.App.3d at p. 511.)

That brings us to the claim that the transfer of functions violates both substantive and procedural due process of law. As to substantive due process (see 7 Witkin, Summary Cal. Law, supra, Constitutional Law § 481, p. 669) Petitioners claim that the transfer is arbitrary. Their legal argument is perfunctory, consisting of a bare citation of a police power case. The citation is inapposite. The wisdom of the legislation is not within our purview. (See American Bank & Trust Co. v. Community Hospital (1984) 36 Cal.3d 359, 369.) The determination of which of two lawful ways of performing the transferred actuarial functions is preferable is a policy judgment for the Legislature. Petitioners offer no persuasive backing for their claim that the alternative selected by the Legislature is irrational.

Petitioners also claim that the transfer scheme violates procedural due process because it does not afford PERS

members notice and a hearing on the determinations assigned to the Actuary. They suggest they have a property right to an actuarially sound PERS funds which may be violated by mistakes the Actuary makes in setting employer contribution rates too low which warrants procedural due process protection. We will assume for the sake of discussion that Petitioners are correct. The claim nonetheless fails on two threshold grounds.

Petitioners make no examination of what process is due. For example, they do not examine the adequacy of the process afforded by judicial review. We are not inclined to develop their gossamer argument on this point in light of their burden to establish the claim of unconstitutionality.

The second shortcoming is that Petitioners fail to show an entitlement to the remedy they seek. They seek to invalidate the transfer of functions on this ground in order to revive the former statutory scheme. (Voiding every statutory mechanism to set employer contributions is no help; that would work the same deprivation of the claimed property right.) However, the former scheme can as easily be faulted along the same lines.

Petitioners suggest that the former scheme provided superior notice and an opportunity to be heard because under it they were afforded the "opportunity to review" proposed actuarial determinations in a hearing before the PERS Board. They fail to cite authority for this claim. If the opportunity is a matter of practice, the same practice could be adopted by the Actuary. The deficiency in process, if any, is not attributable to a difference in the statutory schemes. (Cf. 7 Witkin, Summary Cal. Law, supra, Constitutional Law, § 519.) Petitioners' remedy, if any, is to seek the creation of an appropriate administrative process by implication from the present statutory scheme. (See generally, Southern Pacific Transportation Co. v. State Board of Equalization (1987) 191 Cal.App.3d

938, 950.) They seek no such remedy in these proceedings, and in view of the undeveloped nature of their arguments, we imply no view of the matter beyond the conclusion that their claim of invalidity is not meritorious.

That leaves their claim that the delegation of powers to the Actuary is improper. Petitioners do not explain how the transfer of functions provides less of a standard for the exercise of the actuarial functions than the antecedent scheme. In light of Petitioners' sketchy argument it suffices to say that the standards for the conduct of the Actuary appear sufficiently set out in Chapter 83 when coupled with the implication that the field of actuarial practice is subject to professional norms known to its practitioners and enforceable, if need be, by the judiciary.

DISPOSITION

None of the claims of invalidity of Chapter 83 tendered by the Petitioners has merit. The alternative writ is discharged and the petition is denied. *(CERTIFIED FOR PUBLICATION.)*

BLEASE, J.

We concur:

PUGLIA, P.J.

DAVIS, J.

APPENDIX B

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(Sacramento)

C011580

PEGGY J. CLAYPOOL, *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

ORDER OF MODIFICATION

[Filed Apr. 13, 1992]

THE COURT:

The opinion of this court filed on March 12, 1992, is modified as follows:

1. On page 30 of the opinion delete the last sentence and insert the following sentence instead.

"Because Chapter 83 has a mandatory second tier under which most new state employees who are miscellaneous and state industrial members of PERS would make no member contributions (§ 20013.75) we asked the parties to factor the absence of such contributions into their calculations of projected benefits under *both* supplemental Cola programs."

2. On page 28 of the opinion delete the first sentence, insert the following sentence and footnote instead and renumber the succeeding footnotes appropriately.

"Petitioners locate the disadvantage principally in the lowered purchasing power maximums for the new supplemental Cola benefits under section 21235.5.[3] "

3. On page 12 delete the last sentence of the first paragraph and insert the following sentence instead.

"Petitioners concede that the funds, credited to retired member accounts, became employer assets for purposes of the effect on the employers' contribution obligations, since they were available to make up part of the ordinary retirement allowance."

This modification does not affect the judgment.

(CERTIFIED FOR PUBLICATION.)

FOR THE COURT:

PUGLIA, P.J.

BLEASE, J.

DAVIS, J.

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[3] Petitioners assert in a reply memorandum that the new supplemental Cola program has the disadvantage of a funding mechanism which generates lower funding in years when the rate of earnings on employee contributions is low. As appears in the text the evidence under the appropriate assumptions shows greater average benefits under the new supplemental Cola program. This is an advantage that compensates for the fluctuations that may occur in poor earnings years.

APPENDIX C

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(Sacramento)

C011580

PEGGY J. CLAYPOOL, *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

OPINION ON DENIAL OF PETITIONS
FOR REHEARING

[Filed Apr. 13, 1992]

Petitioners and respondent PERS Board seek rehearing on numerous grounds. The Governor contends that none of their claims warrant granting rehearing. We agree. Most of the claims need no discussion as the opinion denying the application for writ of mandate (Opinion) or the Governor's answer to the petitions for rehearing provides a satisfactory response.

Preliminarily we note that the PERS Board suggests that rehearing is mandatory for failure of the court to afford it an opportunity to present its views upon principles of law it claims were not proposed or briefed by either party, as required by Government Code section 68081. Section 68081 is as follows: "Before [rendering a decision] based upon an issue that was not proposed or

briefed by any party to the proceeding, the court shall afford the parties an opportunity to present their views on the matter through supplemental briefing. If the court fails to afford that opportunity, a rehearing shall be ordered upon timely petition of any party."

The Board misreads the section. It is addressed to issues. If an issue has been tendered the court may apply rules, principles, or theories of law to its resolution without affording mandatory supplemental briefing. The language of Senate Bill No. 2321, the vehicle by which section 68081 was enacted, was amended to substitute the word "issue" for the phrase "a rule, principle, or theory of law." (Assem. Amend. to Sen. Bill No. 2321 (1986 Reg. Sess.) July 9, 1986.) Doubtless this change reflects a desire to avoid an endless cycle of mandatory rehearings that could be broken only by parroting the briefs of one of the litigants. None of the claims presented in the petitions for rehearing show that the Opinion is based upon an "issue" that was not proposed or briefed by a party.

I

Petitioners contend that the Opinion's conclusion that the mandatory second tier provision does not unconstitutionally impair rights of contract is erroneous. They argue that it is inconsistent with the legislative history of the former supplemental Cola provisions, which they claim shows that, in the removal of sunset provisions, the Legislature intended them to be permanent. The argument misses the point. We assume the premise to be correct; however, most legislation is intended to be permanent in the sense that the Legislature does not foresee its repeal when enacted. That does not mean there is a statutory *promise* not to adversely alter related statutes. In any event we note that there is still a supplemental Cola program, only not the one Petitioners desire.

II

Petitioners contend that the Opinion is based upon the false assumption that Chapter 83 eliminates employee contributions. They suggest that the court is not aware that the mandatory second tier provision applies only to new state miscellaneous and state industrial employee members. The court is aware of the limitation and the Opinion will be modified to make this manifest. Petitioners argue that rehearing is appropriate because the effect of imposing the mandatory second tier on the former supplemental Cola programs was "not fully developed in the briefs." This issue was squarely posed by the court's questions to the parties and Petitioners make no satisfactory explanation for their failure to develop the matter when given an opportunity to do so. As the Opinion notes, Petitioners took the position that the effect of the second tier provision was critical. Their application for rehearing fails to show the existence of new material evidence likely to change the resolution of the issue.

III

Petitioners contend that the Opinion is deficient in failing to note an additional disadvantage of the new supplemental Cola funding mechanism. They note that in a reply memorandum they asserted that the new supplemental Cola program has the disadvantage of a funding mechanism which generates lower funding in years when the rate of earnings on employee contributions is low. But they do not show in what way this observation reveals a deficiency in the Opinion. The evidence shows that greater *average* benefits would accrue to beneficiaries given the validity of the mandatory second tier provision. This is an advantage that compensates for fluctuations that may occur in poor earnings years. The opinion will be modified to address this point.

IV

The PERS Board contends that the Opinion is based on the false premise that the PERS fund is presently in actuarial balance.

Here, as in Valdes v. Cory (1983) 139 Cal.App.3d 773, the relationship between the employers' periodic contribution obligation and the attainment of actuarial soundness has never been adequately developed by the litigants. For that reason we did not specify what actuarial measure is to be applied to the obligation. The PERS Board submits that the PERS fund is not presently actuarially sound, that there is an unfunded liability which exceeds the present annual periodic contribution obligation. This is immaterial under the rationale of the Opinion.

If there is a present unfunded liability the implication to be drawn is that the contractual obligation of PERS employers to make periodic contributions either requires something less than the actuarial balance of funds and liabilities or is predicated upon a schedule under which actuarial soundness will be achieved at a point in the future by incremental progress. (See Gov. Code, § 20130.5.) In either event, the measure of the PERS employers' contract obligation is to periodically supply funds needed to reach the target level. The PERS Board does claim that there is some contractual constraint which requires the State to close the gap of unfunded liability more rapidly than called for by the periodic contribution obligation. Accordingly, that gap has no bearing on the reasoning presented in the Opinion.

V

The PERS Board claims that the Opinion's reasoning is incorrect because it permits the former supplemental Cola funds to be credited immediately rather than amortized as is the actuarial practice with unanticipated gains

and losses.[1] The PERS Board offers scant evidence of the stringency, nature, or extent of the claimed practice upon which this untimely new argument is founded. There is no showing that such a practice, if any, applies to the unique circumstances of this case. It might well be prudent to amortize peaks and valleys in earnings, on the notion that whatever economic force has swung the pendulum in one direction may well rebound during the amortization period. But the funds in issue are not analogous to earnings in this respect.

VI

The PERS Board claims that the Opinion is mistaken in asserting that Petitioners concede that pour over funds credited to retired member accounts under the former supplemental Cola scheme "became employer assets, since they were available to make up part of the ordinary retirement allowance." It acknowledges that Petitioners adduced a flow chart developed by PERS staff depicting the funding scheme and that it calls this crediting a transfer to "employer assets." It disavows this characterization as legally and factually incorrect. However, since the transfer results in funds which are to be counted in the calculation of the employer contribution obligation[2] the gist of the characterization is fair. However, in the interest of clarity we will modify the Opinion to qualify the characterization.

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[1] The argument offers dubious benefits to Petitioners at best, since deferred crediting would not prevent the use of the former supplemental Cola funds to defray employer contributions, but only require that the offset be taken over time.

[2] Petitioners' expert actuarial witness described the credit transfer as follows. "Monies which spill over from the IDDA account go first to a retired life reserve . . . which has the effect of reducing employer contributions."

VII

The PERS Board claims that the Opinion is incorrect in equating the process due under the present and former schemes for setting actuarial standards because it is subject to the Bagley-Keene Open Meeting Act (Act; Gov. Code, §§ 11120-11131) but the Actuary is not. It fails to identify the provisions of the Act which provide for notice and an opportunity to be heard. In fact the requirement under the Act for a public meeting, falls far short of a due process hearing, even of the notice and comment variety. (See generally, 2 Davis, Administrative Law Treatise (2d ed. 1979) (Chapter 10.)

DISPOSITION

The petitions for rehearing are denied.

BY THE COURT:

PUGLIA, P.J.

BLEASE, J.

DAVIS, J.

APPENDIX D

Third Appellate District No. C011580
S026183

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA
IN BANK

PEGGY J. CLAYPOOL *et al.*,
Petitioners

v.

PETE WILSON, ETC. *et al.*,
Respondents

[Filed Jun. 18, 1992]

Petitions for review DENIED.

Mosk, J. and Kennard, J. are of the opinion the petitions should be granted.

The request for an order directing depublication of the opinion is denied.

/s/ Lucas
Chief Justice

APPENDIX E

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

Article XVI, section 17, adopted in 1984, in pertinent part reads as follows:

> "Notwithstanding provisions to the contrary in this section and Section 6 of Article XVI, the Legislature may authorize the investment of moneys of any public pension or retirement system, subject to all of the following:
>
> "(a) The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> "(b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system."

The California Government Code, as of January 1, 1991, included the following provisions:

20026. "Regular interest" means interest at the annual interest rate fixed by the board for purposes of crediting of interest, compounded annually.

20026.1. "Annual interest rate" means the interest rate fixed by the board for purposes of crediting interest.

20100. The board of administration of this system is continued in existence.

It consists of:

(a) One member of the State Personnel Board, selected by and serving at the pleasure of the State Personnel Board.

(b) The Director of the Department of Personnel Administration.

(c) The State Controller.

(d) The State Treasurer.

(e) An official of a life insurer and an elected official of a contracting agency, appointed by the Governor.

(f) One person representing the public, appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

(g) Six members elected under the supervision of the board as follows:

(1) Two members elected by the members of the system from the membership thereof.

(2) A member elected by the active state members of the system from the state membership thereof.

(3) A member elected by and from the active local members of the system who are employees of a school district or a county superintendent of schools.

(4) A member elected by and from the active local members of the system other than those who are employees of a school district or a county superintendent of schools.

(5) A member elected by and from the retired members of the system. This section shall become operative on January 16, 1984.

20127. The board shall keep in convenient form such data as is necessary for the actuarial valuation of this system. As of June 30, 1950, and thereafter at the ends of periods not to exceed four years, it shall cause to be

made an actuarial investigation into the mortality, service and compensation experience of members and persons receiving benefits and an actuarial valuation of the assets and liabilities of this system. From time to time it shall determine the rate of interest being earned on the Retirement Fund after deducting from earnings amounts applied to costs of administration of the system.

20130. Upon the basis of any or all of such investigation, valuation, and determination, the board shall adopt such mortality, service and other tables and annual and actuarial interest rates as it deems necessary.

A change in interest rate adopted by the board shall not apply to any election of a member to deposit or redeposit contributions, including interest, filed prior to the date such change was placed into effect.

20131. The board shall credit all contributions of members and retired members in the retirement fund with interest at the current annual interest rate, compounded at each June 30th. The board may set the current annual interest rate at the level which provides for the maintenance of the Investment Dividend Disbursement Account and the Purchasing Power Accounts as specified in Section 21235, 21236, and 21237. For the purposes of this section, the current annual interest rate shall be not less than the current actuarial interest rate. In crediting interest for any fiscal year to contributions of members made during that year, the board may apply one interest rate to the total of such contributions made through the month next preceding the date through which interest is credited, under the assumption that such contributions were made in equal monthly amounts from the July 1st next preceding, to said month, both inclusive.

20200. The "State Employees' Retirement Fund" in the State Treasury is continued in existence. On and after October 1, 1967, said fund shall be known as the "Public Employees' Retirement Fund."

The Public Employees' Retirement Fund is a trust fund created, and administered in accordance with the provisions of this part, solely for the benefit of the members and retired members of the system and their survivors and beneficiaries.

20201. The board has the exclusive control of the administration and investment of the Retirement Fund.

20203.3. Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries.

20652. If the state service or membership herein of a member is discontinued, he or she shall, upon his or her request, be paid his or her accumulated contributions, if, in the opinion of the board, he or she is permanently separated from state service or membership by reason of the discontinuance.

This section shall not apply to discontinuance of state service or membership as a result of retirement or death on account of which a basic, a limited, or a special death benefit is payable.

20684. Each member's contribution deducted and remitted or otherwise paid to the board shall be credited by the board, together with regular interest, to an individual account of the member for whom the contribution was made. Payment of salaries or wages less such contribution is in full discharge of all claims and demands whatsoever for the service rendered by the members during the period covered by such payment, except the benefits afforded by this part.

20750.9. The rates of contribution fixed under this chapter shall be effective on the operative date of the amendments to this section at the 1971 Regular Session; provided that if such rate is greater than the current

rate of a contracting agency, its effectivity shall be deferred and the current rate continued with respect to such agency on request of its governing body until July 1, 1972, in which case an amount equal to the additional contributions which would have been made by the contracting agency had such deferral not occurred shall be transferred from the contributions of the contracting agency held for liability to be funded pursuant to Section 20750.8 to the contributions held for liabilities of all employers in accordance with Section 20758. Rates of contributions as fixed under this chapter shall be adjusted thereafter from time to time by the board pursuant to actuarial valuation of the liability for benefits on account of the employees of all public employers. Any adjustment of such rate of contribution shall be effective on the July 1 following notice as provided in this section. The board shall report such adjustment to the Governor, the Legislature, and the governing body of every other public employer before March 1 of the fiscal year preceding that in which the adjustment becomes effective.

21235. (a) The board shall establish an Investment Dividend Disbursement Account in the retirement fund consisting of that amount of the earnings of the retirement fund which remains after the sequential application of Sections 20202.5, 20203, 20131.1, and 20131. The board shall establish in the retirement fund such Purchasing Power Accounts, based on relative purchasing power, as the board deems necessary, which Purchasing Power Accounts shall consist of the amount of earnings of the retirement fund determined pursuant to Section 21237.

(b) The Investment Dividend Disbursement Account may be utilized, as specified in subdivision (e), to increase all monthly allowances paid by the system to an amount equal to a maximum of 75 percent of the purchasing power, as determined by the board, of the initial monthly allowances that were received by every retired

person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. If sufficient funds are not available within a Purchasing Power Account to adjust allowances to a maximum of 75 percent of purchasing power, the board may transfer funds maintained in the Investment Dividend Disbursement Account to the Purchasing Power Account to provide for the increases authorized by this section. If sufficient funds are not available in any particular Purchasing Power Accounts to adjust allowances to a maximum of 75 percent of purchasing power, the board may adjust allowances to eligible recipients by a lesser amount. The board may, for reasons of insufficient funds, determine that no increase under this section shall be made.

(c) The amount specified in subdivision (a) is hereby appropriated from the Investment Dividend Disbursement Account and from such Purchasing Power Accounts as have been established to the board without regard to fiscal years. Whenever the board determines that there are sufficient funds the board shall apply those funds to the increases authorized by this section.

(d) The board shall inform each recipient of benefits under subdivision (b) that the increases are not cumulative, not part of the base retirement allowance, and may be available for only a limited period of time and that the board may discontinue the increases.

(e) The board, on January 1, 1984, and, upon the commencement of each quarter thereafter, shall pay the benefit provided by this section for the succeeding quarter.

21236. (a) The board shall pay, on October 1, 1984, and at the beginning of each succeeding calendar year, from any funds in a Purchasing Power Account not then needed for the purposes of Section 21235, the amount required for the purposes of this section, which is appropriated to the board without regard to fiscal years, for use for the sole purpose of providing quarterly increases

as specified in subdivision (d) in the monthly allowance of every person who was eligible to receive the 10 percent quarterly increase provided by Section 21232 on September 30, 1984.

(b) Whenever the board determines that there are sufficient funds in a Purchasing Power Account, the board shall apply those funds to the increases authorized by this section. If the funds in a Purchasing Power Account are not sufficient to pay the increases prescribed in subdivision (d), the board shall proportionately reduce all payments.

(c) The board shall inform each recipient of benefits under subdivision (a) that the increases are not cumulative and shall not be included in their base allowance and may be available for only a limited time.

(d) The total quarterly increases payable shall be the difference between the July 1, 1984, 10 percent quarterly payment under Section 21232 and the amount payable under Section 21235 at the time a payment under this section would be made. Whenever the amount payable under Section 21235 is equal to or greater than the amount payable under Section 21232 on July 1, 1984, there shall be no amount payable under this section.

21237. (a) Notwithstanding any other provision of this part, effective January 1, 1986, the Investment Dividend Disbursement Account shall consist of an amount not to exceed the amount of the funds transferred from the Reserve for Deficiencies to the Investment Dividend Disbursement Account on June 30, 1983, less the amount of investment earnings attributable to member accounts for fiscal year 1982-83, plus future account earnings. The board shall annually credit interest to the account at the same crediting rate used to credit retired member reserves. The board may utilize the earnings on the account attributable to the period from June 30, 1983, through June 30, 1985, to credit contributions of members in the retirement fund. That additional interest credit-

ing shall not exceed one percent of the balances in member accounts. Transfers authorized by the board pursuant to subdivision (b) of Section 21235 shall reduce the maximum allowable account balance by the amount transferred.

(b) All other funds available pursuant to Section 21235 shall be retained in Purchasing Power Accounts. The board shall annually transfer from the Purchasing Power Accounts any funds in excess of the amounts disbursed pursuant to Sections 21235 and 21236 in the four previous fiscal years, as provided in subdivision (c). Of the amount so transferred, an amount not to exceed the amount disbursed from the Purchasing Power Accounts in the immediately preceding fiscal year shall be transferred to the appropriate retired member accounts, as determined by the board; and the residual amount shall be transferred to the Extraordinary Performance Dividend Account.

(c) The board shall annually determine, pursuant to subdivision (c) of Section 21221, the extent to which the purchasing power of benefits provided by the system have decreased. The board shall annually transfer from the Purchasing Power Accounts, as provided in subdivision (b), any funds in excess of those disbursed pursuant to Sections 21235 and 21236 for the four previous fiscal years.

21238. (a) The board shall establish an Extraordinary Performance Dividend Account in the Retirement Fund consisting of the amount of earnings of the Retirement Fund transferred from the Purchasing Power Accounts pursuant to Section 21237.

(b) The board shall from time to time on or after January 1, 1991, but only in a fiscal year in which the purchasing power of all persons receiving payments from the Purchasing Power Accounts is 75 percent, disburse, not more frequently than quarterly, extraordinary performance dividend payments to those retired persons and

those survivors and beneficiaries of state, school, and local members and retired persons whose allowances, after applying the annual cost-of-living adjustments and all other increases in allowances required or authorized by this part, have the lowest purchasing power percentage, based on the amount that would be paid had the original allowance been increased by increases in the Consumer Price Index, as defined by subdivision (c) of Section 21221, increasing those allowances to a common minimum purchasing power level. The payments shall be paid by a separate identifiable warrant.

(c) The amount specified in subdivision (a) is hereby appropriated from the Extraordinary Performance Dividend Account to the board without regard to fiscal years. Whenever the board determines that there are sufficient funds in the Extraordinary Performance Dividend Account, the board shall apply that portion of those funds deemed prudent by the board to any payments authorized by this section.

(d) The board shall inform each recipient of benefits under subdivision (b) that the payments are not cumulative, not part of the base retirement allowance, and may be available only as a result of extraordinary investment returns to the system.

1991 Cal. Stat. ch. 83 repealed, *inter alia*, Cal. Gov't Code §§ 20131, 20750.9, 21235, 21236, 21237 and 21238. The following sections *inter alia*, were added or amended as follows:

§ 20006. Actuary; appointment; contract

(a) "Actuary" means an individual or firm practicing as an enrolled consulting actuary appointed by the Governor under contract with the Governer's Office. The contract shall not be subject to any provisions of law relating to competitive bidding. The contract shall be for a fixed period of time not to exceed three years as determined

by the Governor. The compensation paid to the actuary and other necessary employees of the actuary shall be fixed by the contract. The actuary under contract with the Governor's Office pursuant to this section may not be awarded a successive contract. All costs of the contract for the actuary shall be paid from the retirement fund on an annual basis. In carrying out duties under this part, the actuary shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution.

(b) The Governer shall submit the name of the actuary to each house of the Legislature. The actuary shall commence serving in office on the day after receipt of confirmation by both houses of the Legislature. However, the appointment shall become effective and be deemed confirmed the 61st calendar day after the submission of the nomination unless a majority of either house affirmatively rejects the nomination. If the 60-day period ends during a recess of the Legislature, the period is extended to the sixth day following the date on which the Legislature reconvenes.

§ 20006.1. Actuarial valuation of liabilities for benefits; investigation into mortality, service, and compensation; determination of interest rate

On an annual basis, no later than December 1 of each year, the actuary shall make an actuarial valuation of the liabilities for benefits under this part on account of employees of the state. As of the effective date of this section, and thereafter at the end of periods not to exceed four years, the actuary shall make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving benefits and an actuarial valuation of the assets and liabilities of this system. From time to time, the actuary shall determine the rate of interest being earned on the Retirement Fund

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after deducting from earnings amounts applied to costs of administration of the system.

§ 20013.75. Alternatives to Second Tier retirement plan: application

(a) It is the intent of the Legislature that the Department of Personnel Administration, in conjunction with the recognized state employee organizations, develop alternatives to the Second Tier retirement plan by June 30, 1992. The alternative plan may include enhanced benefits or provide benefits under a defined contribution program. However, the state employer's contribution to the alternative plan shall not be greater than the state's contribution rate to the current Second Tier. At the time that an alternative plan is agreed to and implemented, employees who were placed in the Second Tier shall be given an opportunity to elect coverage in the new alternative plan. In the event no alternative plan is implemented by June 30, 1992, employees shall remain in the Second Tier.

(b) Notwithstanding any other provision of this article, persons who first become state miscellaneous or state industrial members of the system on or after the effective date of this section who are: (1) excluded from the definition of state employee in subdivision (c) of Section 3513; (2) supervisory employees as defined in Section 3522.1; (3) employed by the executive branch of government who are not members of the civil services; and (4) defined in subdivision (c) of Section 3513 shall become subject to Section 21251.146.

(c) This section shall not apply to state miscellaneous members employed by the California State University or employees described in Section 20364.

§ 20026. Regular interest

"Regular interest" means interest at the annual interest rate fixed by the *actuary* for purposes of crediting of interest, compounded annually.

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§ 20026.1. Annual interest rate

"Annual interest rate" means the interest rate fixed by the *actuary* for purposes of crediting interest.

§ 20127. Data for actuarial valuation of system; actuarial investigation and valuation; rate of interest on fund

The board shall keep in convenient form such data as is necessary for the actuarial valuation of this system.

* * *

§ 20131.01. Disbursement of funds upon repeal of §§ 21235, 21236, 21237, and 21238

Funds remaining in the Investment Dividend Disbursement Account, the Purchasing Power Accounts, and the Extraordinary Performance Dividend Account upon the repeal of Sections 21235, 21236, 21237, and 21238, shall be used to reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted.

§ 20132.6. Credit of contributions of members and retired members in the retirement fund; interest; reductions; excess funds

(a) The board shall credit all contributions of members and retired members in the retirement fund with interest at the current annual interest rates compounded at each June 30. Except as provided in subdivision (b), the current annual interest rate shall not be lower than the current actuarial interest rate.

(b) In any fiscal year in which the net earnings rate does not exceed the current actuarial interest rate by 110 basis points, the current annual interest rate to be credited to member and retired member contributions may be reduced by an amount that is no more than 110 basis points

less than the net earnings rate in order to provide the amount specified in Section 21235.5.

(c) If the current net earnings rate exceeds the annual interest rate used to credit the member and retired member accounts, in addition to the amount transferred to the fund established under Section 21235.5, the remaining amount shall be credited to employer accounts.

(d) It is the intent of the Legislature that the annual interest rate for crediting member contributions and the actuarial interest rate shall be determined independently of the amount needed to fund Section 21235.5.

§ 20203.3. Expending of funds; limitation to administration of system, investments, reduction of employer contributions, and benefits to members

Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, *the reduction of employer contributions*, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries.

§ 20652.5. Credit of accumulated contributions to member's account; interest

(a) Notwithstanding any other provision of this part, any member of this system who is paid his or her accumulated contributions shall receive the sum of all accumulated contributions credited to his or her account. The accumulated contributions shall include: (1) the interest which had been credited to the member's account prior to the effective date of this section; plus (2) the contributions and interest which had been credited after the effective date of this section at an interest rate of 6 percent annually compounded.

(b) The interest amount which would have been otherwise credited to the member's account on or after the effective date of this section, but for the return of the member's accumulated contributions, shall be transferred to the account established by the board under Section 21235.5 to fund the purchasing power protection allowance.

§ 20750.905. Adjustment of state contributions; determination of employer contribution rates

(a) Notwithstanding any other provision of law, the state's contribution as fixed under this chapter shall be adjusted thereafter from time to time in the annual Budget Act according to the following method. As part of the proposed budget submitted pursuant to Section 12 of Article IV, of the California Constitution, the Governor shall include the contribution rates submitted by the actuary of the liability for benefits on account of employees of the state. The Legislature shall adopt the actuary's contribution rates and authorize the appropriation in the Budget Act.

(b) The employer contribution rates for all other public employers under this system shall be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of change in rate.

§ 21235.5. Transfer of funds to supplemental account; utilization

(a) On an annual basis, the board shall transfer the lessor of: (1) the amount necessary to increase all monthly allowances paid by the system to 75 percent of the purchasing power of the initial monthly allowances; or (2) up to 1.1 percent of the net earnings on member contributions, as determined by Section 20132.6, to a supplemental account.

(b) The funds so transferred to the supplemental account shall be utilized to increase all monthly allowances

paid by the system up to a maximum of 75 percent of the purchasing power, as determined by the actuary, of the initial monthly allowances that were received by every retired person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. Funds remaining in the account after the payment of benefits under this section shall be transferred to the employer accounts.

§ 21236.5. Duration of § 21235.5

If a court of competent jurisdiction, from which all appeals are final, holds that Section 20131.01 is invalid, Section 21235.5 shall become inoperative.